

Credit Policy Improvement Program

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Submitted by:

Development Alternatives, Inc. (DAI)
Contractor

*International Management and Communications
Corporation (IMCC)*
Sub-Contractor

*4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila*

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ABBREVIATIONS AND ACRONYMS

ADB	-	Asian Development Bank
AFMA	-	Agricultural Fisheries Modernization Act
AMCFP	-	Agro-Industry Modernization Credit and Financing Program
AO	-	Administrative Order
BSP	-	Bangko Sentral ng Pilipinas
CDA	-	Cooperative Development Authority
CPIP	-	Credit Policy Improvement Program
CECAP	-	Central Cordillera Agricultural Programme
DA	-	Department of Agriculture
DCPs	-	Directed Credit Programs
DOF	-	Department of Finance
DSWD	-	Department of Social Welfare and Development
EO	-	Executive Order
IMCC	-	International Management and Communications Corporation
GOV	-	Government of the Philippines
GFI	-	Government Financial Institutions
GOCCs	-	Government-Owned and Controlled Corporations
GNFAs	-	Government Non-Financial Agencies
GBA	-	General Banking Act
GFSME	-	Guarantee Fund for Small and Medium Size Enterprises
MCPs	-	Mandated Credit Programs
MFI	-	Micro-Finance Institutions
NBFI	-	Non-Bank Financial Institutions
NCC	-	National Credit Council
NGOs	-	Non-Government Organizations
PDTF	-	People's Development Trust Fund
Quedancor	-	Quedan and Rural Credit Guarantee Corporation
SBGFC	-	Small Business and Guarantee Fund Corporation
SEA-K	-	Self-Employment Assistance - Kaunlaran
USAID	-	United States Agency for International Development

I. Background

Program Description. The Credit Policy Improvement Program (CPIP) is a technical assistance to the National Credit Council (NCC) that is funded by the United States Agency for International Development (USAID). The NCC is an inter-agency policy council chaired by the Secretary of Finance whose membership includes representatives from concerned government agencies and the private sector. NCC has the following mandates: i.) rationalize and optimize government credit programs; ii.) develop a credit delivery system that incorporates capability upgrading and institutional strengthening mechanisms; iii.) encourage greater private sector participation in the delivery of credit; and iv.) define and rationalize the role of guarantee programs and guarantee agencies.

In providing technical assistance, CPIP has the following goals: (1) the effective functioning of the government policy making agency on credit, the NCC; (2) the rationalization of the government's policies on credit, savings and loan guarantees; and (3) the creation of an enabling policy environment that will facilitate the increased participation of the private sector, including microfinance institutions (MFIs), in the provision of financial services to all sectors of the economy, including the basic (poor) sectors.

Initial cost of the project was estimated at US\$ 1.788 million for the period November 1996 to October 1998. As the importance and effectiveness of the policy reforms being pursued by the NCC became more evident, and with a number of additional work areas identified, CPIP has been successively extended to February 2006, with the total amount of assistance increased to more than \$4 million¹.

Program Areas. To encourage greater and sustained private sector participation in the delivery of financial services to the rural poor in particular, CPIP focused on three major areas: the formulation and adoption of government policies to terminate direct government intervention in the provision of credit to the basic sector, especially the heavily subsidized programs implemented by government non-financial institutions; support for the establishment of an information infrastructure for transparency and other elements necessary for improved performance of microfinance institutions, credit cooperatives in particular; and support for the NCC to become an effective and permanent body within the government bureaucracy for the pursuit of improved rural finance policies and infrastructure.

Program Methodology. CPIP has two major components: (1) policy review and analysis of all government directed credit and loan guarantee programs, technical support for the implementation of policy changes to eliminate distortions in financial intermediation, and the determination of viable alternatives to directed credit and loan guarantee programs; and (2) advocacy to promote the rationalization of government directed credit and loan guarantee programs and to encourage the implementation of viable alternatives through the creation of an appropriate policy and regulatory environment that will encourage greater private sector participation in the delivery of financial services to the basic sector.

¹ The chronology of the extension periods and the corresponding costs are shown in Annex A-1.

i. Policy Review and Analysis

CPIP conducted in-depth analytical studies, which provided the empirical data that was used by the NCC as the basis for formulating and implementing specific policy reforms in government credit programs. (See Annex A-2 for a list and brief summary of the various policy studies conducted under CPIP). An inventory and survey of all government directed credit programs followed by an assessment of the performance of the institutions (both Government Non-financial Agencies (GNFAs) and Government Financial Institutions (GFIs), were conducted at the start of the project. The studies conducted were developed into policy notes², which contain the key results and policy recommendations. Policy notes were used as briefing materials for key members of the executive and legislative branches of government and concerned stakeholders from the private sector such as banks, cooperatives and microfinance institutions. Information from these studies was also used to develop the credit policy reform agenda and to convince key policymakers to adopt and implement specific policy measures.

ii. Advocacy

Several advocacy strategies were adopted to ensure support for the policy reform agenda. These strategies are primarily aimed at maximizing support and minimizing opposition from all concerned stakeholders.

Government ownership of the policy reform. The key strategy adopted was to work closely with the key officers of the NCC and its secretariat³ to ensure ownership of the reform agenda. The NCC, being comprised of representatives from various government agencies and from the private sector, provided the appropriate venue for policy discussions. Results of CPIP studies were presented and used as the basis for policy discussions and recommendations. The collegial nature of the NCC allowed CPIP to solicit support from key agencies of government that have major stakes in the proposed policy reforms (i.e., the rationalization of DCPs and the adoption of market-based credit policies).

Issuance and distribution of policy notes. Aside from participating in policy discussions, CPIP also distributed policy notes containing key results of studies conducted. These policy notes were brief and used non-technical, simple and easy-to-understand language since they are directed at key officials that do not have the luxury of time to read lengthy technical studies. The policy notes were distributed to key members of the executive and legislative branches of government and concerned stakeholders from the private sector such as banks, cooperatives and microfinance institutions (MFIs). Policy briefings using these policy notes were also conducted for relevant members of congress and their technical staffs.

Conduct of regional consultations. To increase support for reform among professionals, policymakers and private sector participants, CPIP sponsored more than 100 conferences

² The policy notes are attached in Annex A-3.

³ CPIP provides technical assistance to both the NCC and its secretariat. The NCC secretariat provides technical support to the NCC. The secretariat is responsible for setting the policy agenda of the NCC and articulating the rationale for proposed policy reforms.

and workshops focused on rationalizing directed credit programs, on improving infrastructure for the effective delivery of financial services to the basic sector and on establishing the necessary and appropriate regulatory infrastructure for the strengthened private sector participation. The proposed policy measures to implement the reform agenda were presented and explained in these conferences, where key stakeholders (i.e., bureaucrats implementing DCPs, financial institutions such as rural banks, microfinance NGOs and credit cooperatives, private sector individuals and congressional staffs) were present. These consultations were held in various parts of the country to generate support from key stakeholders such as the farmers, micro-entrepreneurs, fisher-folk and private financial institutions. The costs and benefits of proposed policy measures were articulated in these consultations. By explaining the merits of proposed policy measures (using the results of CPIP technical studies), CPIP was able to generate support for the policy measures from stakeholders, thereby minimizing opposition when presented to policymakers. This strategy allowed stakeholders to be part of the policy formulation process and eventually owners of the policy proposals.

Creation of working groups. To promote ownership and identification with the policy reforms, the NCC through CPIP created various working groups that included representatives of concerned government agencies and the private sector. Results of technical studies conducted by CPIP were used as the basis for discussion in these working groups, where initial policy recommendations were formulated. For instance, technical working groups on the following were created: formulation and establishment of the various information infrastructure for effective regulation of cooperatives engaged in savings and credit operations, formulation of the regulatory framework and the performance standards for MFIs. CPIP also provided local consultants knowledgeable in the topics being discussed by the various working groups.

Technical support in key policy meetings. CPIP further supported NCC through one-on-one meetings with key legislators and executive officials, drafted key parts of various laws and regulatory norms for concerned agencies, and maintained vigilance through attendance at committee hearings of both houses of congress and other inter-agency meetings related to credit policies and programs.

Building capabilities in the executive, legislature and private sector. Since measures being proposed include major policy shifts, key policy makers and legislators have to be convinced of the merits of the reform. In view of this, results of studies were supported by examples and experiences from other countries and institutions that had implemented similar reforms. Thus, CPIP also sponsored foreign study visits for key private sector and government officials to selected private financial institutions in countries where market-based credit policies are employed. Visits to policy makers and regulatory authorities in these countries were also conducted. Aside from exposing the participants to various best practices in the implementation of market-based credit policies, the study visits also allowed policymakers participating in the study visits to share insights from the best practices and how these can be effectively adopted in the Philippines. The visits also allowed the participants to “bond” with each other, thus facilitating the coordination of support for the market-based credit policy reforms.

II. EXPECTED RESULTS

At the conclusion of the contract, the NCC will have the following program outputs: completed policy reviews/studies; data base on directed credit programs, loan guarantee programs and draft legislation; and administrative and executive orders for improving the credit policy environment, especially for the basic sectors. A key output is the rationalization of the government's policies and programs on credit, savings and loan guarantees.

The technical assistance is also expected to focus on the provision of technical assistance in the design and implementation of the necessary viable alternatives to DCPs. As the various policy measures for the rationalization of directed credit programs were instituted, CPIP activities during the succeeding extension periods were geared towards accomplishing the following:

- Institutionalization of NCC through the issuance of a more formal directive (i.e., an Executive Order) that would mandate NCC to review, evaluate and formulate market-oriented credit policies and monitor compliance with the credit policy reforms that have already been put in place;
- Effective collaboration with donors by NCC through the adoption of a policy on the use of donor funds for financial operations, including microfinance;
- Full implementation of the rationalization of DCPs;
- Adoption of a consistent chart of accounts and performance standards for credit cooperatives by the stakeholders and the appropriate regulatory bodies;
- Establishment of an appropriate regulatory environment for cooperatives with savings and credit services;
- Formulation of an appropriate regulatory framework and performance standards for various types of institutions carry out microfinance operations, which considers, among others, minimum capitalization requirements, loan loss provisioning, liquidity ratios and other prudential norms;
- Establishment of the appropriate policy and legal environment for a more vibrant and effective credit bureau industry

III. Key Project Results

Publication of Policy Studies. The studies conducted under CPIP were published and distributed to key technical officers of concerned agencies in the legislative and executive departments (Annex A-2 provides a list and description of the various studies conducted under CPIP). These studies provided the NCC empirical data that were used as a basis for the formulation and implementation of specific credit policy reforms. The survey and inventory of DCPs and the results of the assessment studies provided specific empirical evidence on the inefficiencies and ineffectiveness of government directed credit programs. The studies also documented the government's fiscal losses brought by the implementation of these programs and the adoption of subsidized credit policies. This information was used by the NCC secretariat in convincing key policymakers to support the credit policy reforms.

Government Adoption of Key Credit Policy Reforms. CPIP provided technical assistance to the NCC in the formulation, advocacy and implementation of the necessary credit policy reforms. Several advocacy strategies were adopted to ensure support for the policy reform agenda. These strategies were aimed at maximizing support and minimizing opposition from all concerned stakeholders.

NCC and CPIP efforts resulted in a number of critical credit policy reforms and thereby contributed to the strengthening of the NCC as the GOP inter-agency body in charge of credit policy formulation and monitoring. These policy reforms are geared towards the development of a viable and sustainable rural and microfinance market. The main ones are:

<i>Policy Measures⁴</i>	<i>Key Provisions</i>
<i>Issuance of the National Strategy for Microfinance (1997).</i>	<ul style="list-style-type: none"> ➤ <i>Market orientation of interest rates.</i> ➤ <i>Rationalization of subsidized directed credit programs</i> ➤ <i>Government to only provide the enabling policy and regulatory environment for the effective delivery of microfinance services by the private sector</i> ➤ <i>Donors primarily as providers of technical assistance, e.g., capacity building</i> ➤ <i>Recognition of savings mobilization as an integral part of successful microfinance programs</i>
<i>Enactment of the Social Reform and Poverty Alleviation Act in December 11, 1997</i>	<ul style="list-style-type: none"> ➤ <i>Defining capacity-building to exclude any and all forms of seed funding, equity infusion, and partnership funds from government to microfinance institutions</i> ➤ <i>Deletion of equity funding from the list of specific uses of the People's Development Trust Fund (PDTF), a trust fund created under the law which is aimed at funding capability building activities for MFIs</i> ➤ <i>Rationalization of directed credit and guarantee programs</i> ➤ <i>Emphasis on savings mobilization</i>
<i>Enactment of the Agricultural Fisheries</i>	<ul style="list-style-type: none"> ➤ <i>Phase-out of directed credit programs in the agriculture</i>

⁴ The issuances on these policy measures are shown in Annex A-4.

<i>Policy Measures⁴</i>	<i>Key Provisions</i>
<i>Modernization Act (AFMA) in December 22, 1997</i>	<p>sector over a four year period (i.e. ending February 2002)</p> <ul style="list-style-type: none"> ➤ Rationalization of loan guarantee programs ➤ Adoption of market-based interest rates ➤ Non-provision of credit subsidies ➤ Review of mandates and performance of government agencies and government financial institutions in light of the rationalization of directed credit programs
<i>Issuance of EO 138 (August 10, 1999) that directs government agencies implementing credit programs to adopt the NCC Credit Policy Guidelines.</i>	<ul style="list-style-type: none"> ➤ Non-participation of government non-financial agencies in the implementation of credit programs ➤ Government financial institutions to be the main vehicle in the implementation of government credit programs ➤ Adoption of market-based financial and credit policies ➤ Increased participation of the private sector in the delivery of financial services
<i>Approval of the design of the Agricultural Modernization Credit and Financing Program (AMCFP).</i>	<ul style="list-style-type: none"> ➤ No further implementation of directed credit programs by government non-financial agencies by end 2002 ➤ Limit lending decisions only to banks, viable cooperatives and microfinance NGOs ➤ Adoption of market-determined lending rates to enable conduits to cover their costs and achieve sustainability in the long run ➤ Focus of the Department of Agriculture on the monitoring and evaluation of the AMCFP, provision of infrastructure, institution building, research and extension and the provision of an appropriate policy environment conducive for increased private sector participation.
<i>Enactment of the General Banking Act (GBA) in May 23, 2000, which includes provisions mandating the Bangko Sentral ng Pilipinas (BSP) to recognize the unique nature of microfinance as it formulates banking policies and regulations.</i>	<ul style="list-style-type: none"> ➤ Lifting of the moratorium on branching, specifically by microfinance banks ➤ Issuance of BSP Circular 272 in January 30, 2001 implementing the microfinance provisions of the GBA ➤ Review of the supervision and examination process to consider the special nature of microfinance i.e. non-collateralized loans
<i>Enactment of the Barangay Microenterprise Business Act.</i>	<ul style="list-style-type: none"> ➤ Adoption of market-based credit policies in the provision of financial services to barangay or village-based microenterprises. ➤ Setting up of a special credit window, within a GFI, that will provide credit to barangay microenterprise business at market based interest rates.

Rationalization of Government Directed Credit Programs. In compliance with the rationalization of directed credit programs espoused in the various credit policy measures adopted, the NCC is working closely with different government non-financial agencies. Latest information from the NCC reveal that of the 85 directed credit programs reported in the 1997 survey, twenty-five (25) have been terminated and twenty-eight (28) have been transferred to GFIs. The NCC has also reported that, since 2000, DBM has neither appropriated nor released any funds to non-financial government agencies for the implementation of government credit programs.

The NCC, with technical support from CPIP, has also worked closely with various donors to ensure that foreign-assisted programs are in line with the credit policy reforms. For instance, programs funded by the European Union (EU) that used to allocate funds for direct provision of credit have been redesigned, especially the area development programs of EU. The redesigned programs are now focused on strengthening institutions and building their capacity for microfinance operations.

Establishment of Support Information Infrastructure. With the implementation of market-based credit policies, and the phase-out of government directed credit programs, alternative credit delivery mechanisms were identified. Credit cooperatives were identified to play a significant role in the delivery of formal financial services in the rural areas along with rural banks and NGOs with credit operations. In a study conducted by CPIP in 1998, it was reported that, despite the credit cooperatives' potential for growth and significant role in the countryside, there is not much information on the extent or depth of their outreach or on their financial performance. This is mainly due to the lack of a uniform and transparent set of information on their financial operations.

In view of this, the work of CPIP through the NCC evolved to include support for the establishment of an information infrastructure for transparency and other elements necessary for effective regulation of financial institutions, credit cooperatives in particular. The following were accomplished during the period of CPIP implementation:

<i>Accomplishment</i>	<i>Purpose</i>
<i>Establishment of the standard chart of accounts for credit cooperatives and other types of cooperatives with credit services</i>	<ul style="list-style-type: none"> ➤ <i>Fosters greater transparency, consistency and uniformity in reporting the operations and performance of credit cooperatives</i> ➤ <i>Provides the necessary tool for the effective supervision and examination of credit cooperatives</i>
<i>Development of the accompanying accounting manual for credit cooperatives and other types of cooperatives with credit services</i>	<ul style="list-style-type: none"> ➤ <i>Provides and specifies the systems and procedures that should be followed in implementing the standard chart of accounts</i>
<i>Establishment of the performance standards for credit cooperatives and other types of cooperatives with credit services</i>	<ul style="list-style-type: none"> ➤ <i>Specifies a set of qualitative and quantitative (financial) indicators to measure the safety and soundness of the operations of credit cooperatives.</i>

To ensure effective adoption and implementation of this information infrastructure, CPIP provided support to the NCC and the Cooperative Development Authority (CDA) in promoting and advocating for the use of the standard chart of accounts and the performance standards. The CDA issued a Memorandum Circular 02-04 Series of 2002 mandating all credit cooperative to adopt and implement the Standard Chart of Accounts for Credit and other Types of Cooperatives with Credit Services.⁵ The CDA has also issued Memorandum Circular 03-04 on June 30, 2003, mandating the adoption of the performance standards for credit cooperatives

⁵ Annex A-5 shows the CDA Memorandum Circular on the adoption of the Standard Chart of Accounts for Credit and other Types of Cooperatives with Credit Services.

as a management and supervisory tool.⁶ As a result of these issuances, GFIs are now using these standards as part of their evaluation criteria for their credit cooperative clients, both in terms of assessing their financial performance and in the granting of appropriate recognition.⁷

Establishment of an Appropriate Regulatory Environment for Microfinance.⁸ The government's decision to provide an appropriate policy environment for the delivery of financial services to the poor and its clear policy directions on microfinance resulted in an increased number of private institutions engaged in the provision of micro-finance services. Because of this, the need for appropriate regulation of MFIs was brought to the fore by both government and microfinance practitioners. Recognizing the importance of appropriate regulation in ensuring the delivery of sustainable and efficient microfinance services, the NCC with technical assistance from CPIP developed the regulatory framework for microfinance. The framework provides the government's thrust and policy direction for the effective regulation and supervision of the Philippine microfinance industry and delineates the role and the responsibilities of each of the players in the microfinance industry in both the public and the private sector. The following basic premises were adopted in the framework:

<i>Area of Concern</i>	<i>Provision in the Regulatory Framework</i>
<i>General Premise</i>	<ul style="list-style-type: none"> Only deposit taking institutions will be subjected to prudential regulation.
<i>Regulation for banks engaged in microfinance operations</i>	<ul style="list-style-type: none"> Banks, including GFIs that provide wholesale funds for microfinance, will continue to be regulated by the BSP. General rules and regulations on bank supervision and examination will be applied. Specific rules that do not discriminate against the peculiar and unique characteristics of microfinance services will also be applied provided these would not unduly affect the stability of the financial system.
<i>Regulation for coops engaged in microfinance operations</i>	<ul style="list-style-type: none"> Credit cooperatives are under the regulatory authority of the CDA. To ensure that there is appropriate regulation and supervision of credit cooperatives, CDA will establish a specialized regulatory unit for credit cooperatives.
<i>Regulation for microfinance NGOs</i>	<ul style="list-style-type: none"> Microfinance NGOs are considered non-deposit taking institutions and therefore will not be subject to prudential regulation and supervision by any government regulatory authority provided that the total savings collected from their clients do not exceed the total loan portfolio of the microfinance NGO at any point in time. Microfinance NGOs that go beyond this compensating balance limit will be encouraged to

⁶ Annex A-6 presents the Performance Standards for Credit and Other Types of Cooperatives with Credit Services.

⁷ The indicators in the COOP-PESOS have been included as part of the evaluation criteria in the Land Bank of the Philippines' (LBP) Gawad Pitak Awards for Cooperatives.

⁸ The approved Regulatory Framework for Microfinance is shown in Annex A-7.

<i>Area of Concern</i>	<i>Provision in the Regulatory Framework</i>
	<i>transform into either a bank or a credit cooperative.</i>
<i>Required support infrastructure</i>	<ul style="list-style-type: none"> ○ <i>A credit information system containing data on all microfinance loans shall be established by the private sector, with the government providing the appropriate policy environment for effective participation.</i> ○ <i>A core set of performance standards for microfinance operations of all types of financial institutions shall be established and adopted by concerned agencies.</i> ○ <i>A transparent set of information to include sex disaggregated data for microfinance will be promoted among all types of microfinance institutions.</i>

In compliance with the basic provisions of the regulatory framework for microfinance, the following activities were completed during the project period:

- i. **Establishment of the Performance Standards for all Types of Microfinance Institutions.** As required under the regulatory framework for microfinance, the NCC in coordination with all concerned stakeholders and with technical assistance from CPIP formulated a common set of performance standards for all types of microfinance institutions. The common set of performance standards for microfinance provide for greater transparency in the operations of MFIs and establishes an industry benchmark that allow the comparison of performance among all institutions engaged in microfinance operations, i.e. banks, cooperatives and microfinance NGOs. The standards will also guide regulators in the assessment of financial institutions under their supervision. The performance standards known as the PESO are comprised of indicators covering the following areas of microfinance operations: **P**ortfolio quality, **E**fficiency, **S**ustainability and **O**utreach⁹. The PESO was formally launched on November 18, 2004, during the Philippine celebration of the International Year of Microcredit.

Recognizing the importance of the PESO standards in developing a viable and sustainable microfinance industry in the Philippines, the following institutions (government and private sector) signed a Memorandum of Agreement¹⁰ to formally adopt and implement the Standards in the conduct of their respective mandates to ensure that MFI operations are efficient, viable and sustainable to provide continued access to microfinancial services by the poor and disadvantaged sectors of society:

Department of Finance, National Credit Council
Bangko Sentral ng Pilipinas,
Securities and Exchange Commission,

⁹ The Performance Standards for all Types of Institutions engaged in Microfinance Operations is shown in Annex A-8.

¹⁰ The signed Memorandum of Agreement is shown in Annex A-9.

Cooperative Development Authority,
Development Bank of the Philippines,
People's Credit and Finance Corporation
Land Bank of the Philippines
Microfinance Council of the Philippines
Rural Bankers Association of the Philippines
National Confederation of Cooperatives

The MOA was signed on October 10, 2005, and was presented to the President of the Philippines on the same date during the culmination of the Philippine celebration for the International Year of Microcredit.

- ii. **Establishment of the appropriate legal environment for the effective functioning of a credit information system in the Philippines.** CPIP provided the necessary technical support to the NCC and the BSP in establishing an appropriate legal and policy environment for effectively functioning credit bureaus in the Philippines. In doing so, the following activities were conducted by the NCC and the BSP with the appropriate technical support from CPIP:

<i>Activity</i>	<i>Purpose</i>
<i>Conduct of a study that reviews the existing legal environment and identifies specific legal provisions that will make participation of financial institutions in the credit bureau more effective, e.g., ensure timely and accurate submission by all financial institutions of all credit transactions of borrower to the credit bureau.</i>	<i>The study, among other things, identifies the legal provision that will allow regulatory authorities to operate and maintain a credit bureau and recommends specific measures that could be undertaken by these regulatory authorities to make participation of financial institutions in the credit bureau more effective, e.g., ensure timely and accurate submission by all financial institutions of all the credit transactions of all borrower to credit bureaus.</i>
<i>Formulation of the operational design for the establishment of an interim credit bureau unit within BSP</i>	<i>The operational design, among other things, identified the manpower, resources, infrastructure and technology requirements of the interim credit bureau unit to be established within BSP. The operational plan also identified the technology and infrastructure requirements of the participating financial institutions. The operational plan will be used by the BSP in allocating the necessary resources for the establishment of the credit bureau unit within BSP.</i>
<i>Drafting of a legislative bill on the establishment of an effective credit information system in the Philippines</i>	<i>The draft bill, will among other things, establish the necessary legal environment for a more effective participation of financial institutions in the credit bureau. The bill specifically mandates the BSP to require the submission of credit information from all regulated financial entities. It likewise directs the Monetary Board to formulate the appropriate policies that will guard the confidentiality of information</i>

<i>Activity</i>	<i>Purpose</i>
	<i>submitted to the bureau to prevent poaching of clients and the use of information in ways other than to determine the creditworthiness of borrowers. The draft bill also directs the Monetary Board to come up with rules and regulations that specifically protects the rights of borrowers.</i>

Based on the results of the legal review, a draft bill on the establishment of an effective credit information system was submitted to Congress in November 2004. The draft bill has the following key features:

- A corporate entity with BSP ownership of up to 49 percent at any time will be established.
- All banking institutions and their subsidiaries and affiliates are required to submit credit information to the Bureau, including even the smallest credits and those both good and bad. The monetary board may determine other credit providers that would be subject to compulsory participation;
- All institutions submitting credit information to the bureau are required to notify their borrowers about the submission of credit information to the bureau and release of such information by the bureau;
- The Monetary Board shall establish rules and regulation on the following: restrictions on the use and transfer of credit information; rights of borrowers to access their credit information and to dispute the factual accuracy of credit information; sanctions to be imposed by the Bureau on submitting entities for non-submission of reports and for delayed and erroneous reporting.

The proposed bill on the establishment of an effective credit information system is currently being discussed in Senate plenary sessions, while the counterpart bill in the lower House is still with the Committee on Banks. While the bill is deemed important by concerned stakeholders in both the government and the private sector, political events and priorities in Congress have resulted in protracted discussions on the proposed bill.

Based also on the findings of the review of the legal environment, the Monetary Board (MB) has approved-in-principle the establishment of a credit bureau unit within BSP as an interim solution to partially bridge the gaps in credit reporting in the Philippines and has granted the authority for BSP management to obtain technical assistance from CPIP-USAID through the National Credit Council for the technical/operational design of a credit bureau unit in BSP on September 1, 2004. Decision on the deployment of personnel and establishment of the credit bureau unit within BSP was, however, deferred inasmuch as the new members of the Monetary Board (those appointed in 2005) decided to re-evaluate the proposed establishment of an interim credit bureau within BSP, considering that there is already a pending bill in Congress that aims to establish a credit bureau as a corporate entity where BSP is allowed to have ownership of up to 49 percent.

Establishment of an appropriate and effective regulatory environment for Cooperatives with Savings and Credit Services. Following the establishment of the necessary support information infrastructure for transparency and effective regulation of cooperatives with savings and credit services, the NCC in coordination with the CDA and with the necessary technical support from CPIP conducted the following:

<i>Activity</i>	<i>Purpose</i>
<i>Formulation of the framework for the effective regulation and supervision of cooperatives with savings and credit services</i>	<ul style="list-style-type: none"> ➤ <i>Defines the structure to be adopted in the regulation and supervision of cooperatives with savings and credit services:</i> <ul style="list-style-type: none"> ○ <i>CDA to issue the rules and regulations for the safe and sound operations of cooperatives with savings and credit services and to accredit cooperative federations and unions to be deputized as supervisors;</i> ○ <i>Accredited cooperative federations/unions to conduct the supervision and examination of primary cooperatives.</i> ➤ <i>Directs the formulation and establishment of the necessary rules and regulations for the safe and sound operations of cooperatives with savings and credit services</i>
<i>Formulation of the Manual of Rules and Regulations (MORR) for cooperatives with savings and credit services</i>	<ul style="list-style-type: none"> ➤ <i>Contains a compendium of the prudential rules and regulations, guidelines and best practices to guide the safe and sound operations of cooperatives engaged in the provision of credit service. It has the following major components:</i> <ul style="list-style-type: none"> ○ <i>General guidelines for the registration and organization of cooperatives with savings and credit services</i> ○ <i>Prudential standards and best practices</i> ○ <i>Good governance policies and ethical standards</i> ○ <i>Organization and management principles</i> ○ <i>Internal control principles and standards</i> ○ <i>Regulations on deposit taking, borrowing and lending operations</i> ○ <i>Model Article of Cooperation and by-laws</i>
<i>Formulation of the accreditation criteria for deputized supervisors</i>	<ul style="list-style-type: none"> ➤ <i>The accreditation criteria will be used by the CDA as the regulatory authority in selecting cooperative federations and unions that will be deputized as supervisors and examiners of primary cooperatives with savings and credit services.</i>
<i>Drafting of the necessary amendments to the Cooperative Code (RA 6938)</i>	<ul style="list-style-type: none"> ➤ <i>The proposed amendments, among other things, provide for the establishment of rules and regulations and performance standards for</i>

<i>Activity</i>	<i>Purpose</i>
	<i>cooperatives with savings and credit services. It also provides for the accreditation of cooperative federations to be deputized as supervisors and examiners of primary cooperatives engaged in savings and credit services.</i>
<i>Drafting of the necessary amendments to the Charter of the Cooperative Development Authority (CDA) (RA 6939)</i>	➤ <i>The proposed amendments strengthen the regulatory mandate of CDA and direct the CDA to supervise and examine the operations of primary cooperatives. The amendments also specify that the CDA's development function will only include those that support its regulatory mandate.</i>

The framework for the effective regulation and supervision of cooperatives with savings and credit services was endorsed for dissemination by the members of the Board of Administration of the CDA during the last quarter of 2003. Since the adoption of the framework will need massive capacity building for both the CDA and the cooperative sector, the Framework and the necessary capacity building needs were presented to the donor community in April 2004. As a result, the Asian Development Bank (ADB) has provided a grant to the NCC and the CDA to build the latter's capacity in implementing an effective regulatory and supervisory environment for cooperatives with savings and credit services.

The adoption of the framework also led to the formulation of the Manual of Rules and Regulations (MORR) for the safe and sound operations of cooperatives with savings and credit services in June 2004 and the drafting of the basic criteria for the accreditation of the cooperatives federations and unions that will be deputized as supervisors and examiners of primary cooperatives¹¹.

The initial draft of the MORR was presented to and discussed in a series of Technical Working Group (TWG) meetings comprised of representatives from relevant government agencies and federations and unions of cooperatives. The final version of the MORR was then presented in twelve regional consultations in which key officers and managers of primary cooperatives engaged in savings and credit operations participated. Upon revision reflecting the issues and comments raised during the consultations, the MORR was presented to the CDA Board of Administrators and its key management officers who endorsed the conduct of Public Hearing on the MORR.¹² To date, members of the TWG in coordination with CDA management have yet to discuss the issues raised during the public hearings prior to its finalization and submission to the President for final approval.

The proposed amendments to the Cooperative Code, on the other hand, have already been approved in the House of Representatives while the proposed amendments to the charter of the Cooperative Development Authority (CDA) have already been discussed in the Committee on

¹¹ The accreditation criteria were drafted under CPIP, but further discussions and finalization of the draft accreditation criteria were deferred based on the recommendation of the TWG members to discuss the criteria upon completion of the MORR and include the criteria as part of supervision manual to be formulated.

¹² The conduct of public hearing is a requirement of law prior to the endorsement of the rules and regulations to the President for its approval.

Cooperatives in the Senate but have yet to be presented in plenary sessions. Deliberations on the proposed amendments have been put on hold due to a number of political events that have affected the priorities in Congress.

IV. LESSONS LEARNED

Identify the partner government agency that will own the reforms being pursued.

Identifying a specific partner agency in government that will pursue and own the policy reform agenda in a technical assistance project is key to ensuring acceptance and adoption of policy reforms by the concerned stakeholders. The officers and officials of partner government agencies, not the consultants hired by the technical assistance project, should be the ones to espouse the merits and benefits of the proposed policy reforms to avoid any preconceived notion of donor interest behind any policy reform agenda. In view of this, it was learned from project implementation that it is always advantageous to use local consultants in convincing key policymakers and stakeholders regarding the benefits and merits of any proposed policy reform. Foreign consultants are particularly helpful in providing expertise for the conduct of technical studies that will be used as bases for recommending specific policy measures and developing relevant policy reform agenda.

Creation of technical working groups for reform ownership. To ensure ownership and to build allies within the government bureaucracy, CPIP used the technical working group mechanism where project consultants would present the results of technical studies containing discussions and empirical evidences regarding specific policy issues and identifying problem areas, issues and specific policy recommendations. The TWG meetings are then used as venue for discussing technical issues and difficulties related to the adoption and implementation of policy reforms. Using this mechanism, the TWG members are enjoined to participate in crafting and eventually owning the policy reforms being pursued. This strategy allowed CPIP to create and build allies within the bureaucracy who eventually supported the reform agenda in various fora, consultations, and relevant executive and legislative meetings.

The TWG mechanism also facilitates the sustainability of policy reforms inasmuch as the TWG members eventually became the advocates and champions of the policy reforms hence providing the necessary support to minimize threats of policy reversals. In the case of developing policy tools such as the performance standards developed under CPIP, it was learned that the TWG mechanism facilitate the adoption of the standards by the concerned institutions inasmuch as they were part of the group that developed the tool¹³.

Conduct of exposure visits to best practices in selected countries adopting the reform agenda.

Exposing key policymakers and legislative officials to best practices in countries where the proposed policy reform has been effectively implemented has proven to be a good project investment. This has been demonstrated in the creation of an enabling policy environment that has generated increased private sector participation in the delivery of microfinance services in the Philippines. Specifically, the inclusion of a specific provision in the General Banking Act (GBA) of 2000 is an offshoot of bringing legislative officials (specifically one of the authors of the bill) to countries in Latin America where Superintendencies of Banks have implemented rules and regulations that do not discriminate against microfinance. As a result, the GBA of 2000 includes a provision that specifically directs the Monetary Board to recognize the peculiar

¹³ For instance, the GFIs are now adopting the PESO standards in evaluating the creditworthiness of MFIs. These GFIs have representatives in the TWG that formulated the PESO standards.

characteristics of microfinance and to come up with rules that will not discriminate against microfinance (e.g., cash-flow based lending). With this provision, the Bangko Sentral has now issued several circulars that provides for a microfinance friendly regulatory environment resulting in more banks going into the provision of microfinance services.

Building stakeholder support for reforms through intensive consultations. To ensure support of stakeholders, including those to be affected by any proposed policy reform, it has been learned that consultation prior to adoption is an important process that generates ownership, support and participation in the policy formulation resulting in better acceptance of the necessary reforms. While consultations could also bring about negative reactions and generate resistance to the reforms, it allows decision makers to come up with more acceptable solutions that will address the reservations of those that will be affected by the reform process. Appropriate adjustments in the policy measures can then be considered prior to adoption and implementation.

V. REMAINING CHALLENGES

Remaining tasks to be accomplished. At contract completion, a number of tasks are yet to be completed. These should be given appropriate consideration by government to ensure increased participation of the private sector in the delivery of financial services to the basic sector. These tasks are deemed essential to ensure that objectives set for the identified activities are met.

- ❑ **Establishment of an Efficient and Effective Credit Bureau.** The need for an effective and efficient credit bureau has by now become recognized among all the stakeholders (i.e., both the regulators and the regulated entities). The catalytic role of the BSP in enjoining the support of regulated financial institutions to participate and submit the necessary credit information to the credit bureau is also deemed important. In this regard, the NCC and the BSP should continue supporting the passage of the bill in Congress that will enjoin greater participation in the credit bureau. It would also be beneficial if the BSP can continue in its initial direction of establishing an interim credit bureau pending the passage of the bill in Congress. Considering the current priorities and pace in Congress and the importance of demonstrating the beneficial effect of a comprehensive credit information system, the establishment of the interim credit bureau is deemed important and necessary. The interim bureau will prepare all regulated institutions to make the necessary adjustments in their reporting systems to enable the submission of the required credit information to the credit bureau.

It is unfortunate that the conduct of an exposure visit to credit bureaus in selected countries that had earlier been proposed under CPIP has been put on the shelf. It is believed that such a visit could have provided concerned legislators and executive officials first-hand information on the merits and importance of an effectively functioning credit bureau. This could have been helpful in facilitating discussions on the bill as well as the discussions among the new set of Monetary Board members in making the decision to push through with the establishment of an interim credit bureau within the BSP.

- ❑ **Building the capacity of the CDA for implementing an effective regulatory environment for cooperatives with credit services.** As of project completion, the necessary information infrastructure (Standard Chart of Accounts, Accounting Manual, Performance Standards (COOP-PESOS), Manual of Rules and Regulations) for effective regulation of credit cooperatives has already been established. While this information is necessary, it is not sufficient for effective regulation and supervision. As stated in the regulatory framework for microfinance, which was developed under CPIP, there is a need to build the capacity of the CDA to effectively implement an appropriate regulatory environment for cooperatives engaged in savings and credit services. Since CDA has in the past mainly focused its efforts on development activities, which are inherently in conflict with its regulatory mandate, regulatory and supervisory capacities among its personnel have yet to be developed. With the new Chairman of the CDA espousing effective regulation of cooperatives as an important task of the agency, and the cooperative sector (concerned cooperative federation and primary cooperatives)

realizing the need for supervision and regulation, donor support is strongly needed to assist the agency build its regulatory capacity and the cooperative sector prepare for the regulatory environment. While the Asian Development Bank (ADB) through the recently approved Microfinance Development Program has already earmarked resources for this, there is stillroom for donor collaboration in supporting the gargantuan task currently facing the agency.

To ensure institutionalization of the regulatory thrust of the CDA, technical support towards the passage of the amendments to the Cooperative Code and the CDA charter are also deemed important.

Further reforms to be pursued

- ❑ **Establishment of an appropriate policy environment for greater private sector participation in the delivery of financial services to the small and medium enterprise sector.** The micro and small enterprise sector has been singled out by the current administration as a priority sector. In view of this, and since this sector can most likely generate added employment, there is a need to review the provision of financial services to the small enterprise sector for the purpose of providing an enabling policy and regulatory environment for greater private sector participation in small enterprise lending. The review should focus specifically on ensuring that policies to be adopted for small enterprise lending are consistent with the general policy framework for the provision of credit and microfinance services adopted so far. Specific consideration should be given to the financial service requirements of micro-entrepreneurs graduating from microfinance towards small enterprise financial requirements. This is deemed especially important considering that any policy inconsistency will have a negative impact on the gains that have been achieved so far in the microfinance sector.
- ❑ **Improving the policy environment for rural finance.** It is observed that, despite the current enabling policy environment allowing greater private sector participation in the provision of financial services to the basic sector, there is still reluctance on the part of private financial institutions to provide adequate financial services to the rural/agriculture sector. This has been mostly due to the various risks associated with rural lending (i.e., systemic risks, idiosyncratic risks, liquidity risks) that are not necessarily present in urban microfinance. Hence, the current microfinance technologies may not be fully adequate to encourage private financial institutions to provide sufficient rural financial services.

The review of the rural finance sector conducted under CPIP identified specific policy recommendations and measures that should be adopted and implemented by the government to ensure the sustainable provision of rural financial services. Savings services in rural areas have been emphasized as among the important mechanisms for reducing the risks and vulnerability of rural clients. Savings services in the rural areas can give clients a safe place for their hard earned resources.

Given the importance of the rural finance sector, especially in ensuring that there are no policy reversals in government credit policies, there is a need to present the issues raised in the study together with the required policy measures to the various stakeholders. Previous CPIP experience has shown the importance of consulting with the relevant stakeholders before the government adopts any policy reform measures. The TWG created for rural finance has in fact come up with the specific steps that should be undertaken by concerned agencies to facilitate the provision of rural financial services. NCC has already included follow-on actions for rural finance as priority in its work plan.

- ❑ **Identifying barriers to savings mobilization.** To encourage greater private sector participation in the provision of financial services to the basic sector, government has issued specific policy measures that prohibit the participation of government non-financial agencies and adopt market-based interest rates in the implementation of credit programs. In view of this, it is important that the private sector be encouraged to mobilize savings as source of loanable funds. To do this, current policies affecting effective and efficient savings mobilization by private financial institutions should be reviewed and evaluated. Specific policy and administrative barriers to savings mobilization by private financial institutions should be identified and appropriate measures adopted by the concerned agencies of government.

Eminent Threats. The policy reform measures adopted by the government to pursue a market-oriented policy environment in the delivery of financial services to both urban and rural areas are considered the major accomplishments of the project. However, policy reversals pose continuing threats to the policy reform measures adopted. There is therefore a need to continue advocacy work within executive departments and Congress to ensure that programs and policies adopted by the various line agencies are in accordance with the credit policy reforms. Continuing advocacy to the donor community should be undertaken to make sure that their programs of assistance support the policy reform measures of the government. The NCC as a policy council chaired by the Secretary of the Department of Finance and comprised of representatives from relevant government agencies is considered the agency that is in the best position to continue shepherding the credit policy reforms that have been adopted.

In line with this, there is a need for continued advocacy for the institutionalization of NCC. NCC was established through an AO without any budgetary provision for its effective functioning. Given threats of possible reversals, there is a need to institutionalize the functions of NCC within the Department of Finance as an organic unit. Under the rationalization program, a unit within the DOF will be created to formulate and coordinate government credit policies in all sectors. This should be considered a priority of government to prevent backsliding in the policy reforms already adopted.

ANNEX 1

Project Cost and Duration

The Credit Policy Improvement Project (CPIP) was intended to be implemented from November 6, 1996, to October 31, 1998, with a total project cost of \$1.78 million. With the depreciation of the peso and the need for continued technical assistance in pursuing market-based credit policy reforms, the original project contract was extended to August 2000.

In the course of project implementation, the project implementing agency and its partner agencies recognized the need to have a permanent body, the NCC that will monitor, coordinate and sustain the credit policy reforms initiated through the technical assistance provided by CPIP. In coordination with the private sector, this body will work on the identification and development of viable alternatives to Directed Credit Programs (DCPs) and continue advocacy work to prevent policy reversals. In view of this, the NCC requested for a twelve-month extension of CPIP technical assistance. The extension period was to help institutionalize the NCC into a permanent body in the Department of Finance (DOF). An additional \$1 million was provided for the twelve-month extension period resulting in a total project cost of \$2.78 million. A contract modification was issued in September 2000 extending the project to May 31, 2001.

In line with the implementation of credit policy reforms (i.e., the rationalization of DCPs in particular), NCC with assistance from CPIP identified viable alternatives to DCPs. Strengthening credit cooperatives through appropriate and effective regulation is recognized as one of the measures that should be undertaken by the government. To ensure that the appropriate policy and regulatory environment for credit cooperatives would be established, CPIP was given a no-cost extension from June 1, 2001, to February 28, 2002.

Upon request of the Philippine Government, the United States Agency for International Development (USAID) provided additional funding amounting to \$250,000 to the CPIP for the period March 2002 to January 2003 and an additional \$60,000 for a three-month extension covering the period February to May 15, 2003. The extension focused on the provision of the necessary advocacy and technical support to the NCC as it worked towards the development of relevant policy and regulatory structures for the effective participation of the private sector in the provision of microfinance services.

To ensure continuing support for the policy reforms already instituted and to continue work on the issues arising from the implementation of the policy measures adopted, the government again requested for an extension of the technical assistance to the NCC. CPIP was then granted an amount of \$987,530 for the period June 20, 2003, to October 19, 2004.¹ This phase of CPIP focused on the provision of necessary advocacy and technical support to the NCC as it works toward the development of the relevant policy and regulatory structures for effective participation of the private sector in the provision

¹ This phase of CPIP was implemented under a new contract arrangement wherein, under AMAP, IMCC is a sub-contractor to Development Alternatives Inc. (DAI).

of microfinance services. Realizing the need for continuing assistance in these areas, CPIP was again extended from October 2004 to February 2006 with additional funding of \$250,000.

Total project resources for the period December 1996 to February 2006 amounted to more than \$4 million.

ANNEX 2

List of Policy Studies Conducted Under CPIP

<i>Title of Study</i>	<i>Brief Summary</i>
1. <i>Directed Credit Programs (DCPs): The Experience and Policy Reform Issues</i>	<i>This study provides a brief survey of all Directed Credit Programs (DCPs) being implemented by the government. Survey results showed that almost half of the eighty-six (86) DCPs are implemented by government non-financial agencies. Majority of the DCPs source their funds from budgetary allocation and foreign assistance from donors (either as loans or grants). The study pointed out that these programs lead to huge fiscal costs (the bulk of which are "hidden" or off-budget) with many of them doing poorly as well in terms of outreach to targeted clients.</i>
2. <i>Assessment of the Performance of Government Financial Institutions (GFIs) and Government-Owned and Controlled Corporations (GOCCs)/Non-Bank Financial Institutions (NBFIs) in Implementing DCPs</i>	<i>DCPs being managed and implemented by GFIs and GOCCs/NBFIs are mixed in the sense that some target small borrowers within a specific sector, while others target a specific sector regardless of the size of the borrowers. Compared to Government Non-Financial Agencies (GNFAs), GFIs perform better in terms of outreach and efficiency. The study also found out that the indirect mode of lending wherein GFIs only engage in wholesale lending to participating financial institutions are a better and more effective approach.</i>
3. <i>Assessment of the Performance of Government Non-Financial Agencies (GNFAs) in Implementing DCPs</i>	<i>The study showed that most of the directed credit programs implemented by GNFAs are not operationally and financially efficient. The income generated by the credit programs is not able to cover the costs of implementation due to high administrative and high default costs. In view of this, the study recommends that the government should spell out a clear policy prohibiting non-financial government agencies from implementing directed credit programs. GNFAs should instead focus on their primary functions and leave credit function to financial institutions.</i>
4. <i>Policy Framework for Rationalizing DCPs</i>	<i>Despite the prior policy pronouncements to terminate and consolidate DCPs, a survey revealed that there are 86 ongoing DCPs in various sectors of the economy. Overall, the survey found out that DCPs have low outreach, financially unsustainable, and exact an enormous fiscal cost on the government. The experience with DCPs demonstrates that these programs have failed to satisfy two (2) important criteria – effective outreach and financial efficiency. Given the observations on the ongoing DCPs and applying the criteria of outreach and sustainability, the paper recommends the adoption and implementation of the following policy strategies: (a) rationalize DCPs by phasing-</i>

<i>Title of Study</i>	<i>Brief Summary</i>
	out the participation of GNFA's in the implementation of DCPs and encouraging private sector participation by mandating GFIs to only focus on wholesale operations; (b) adopt market-based interest rate; and (c) formulate and adopt alternative mechanisms for the delivery of credit.
5. <i>Review of Financial Laws and Regulations Affecting the Provision of Financial Services to the Basic Sectors</i>	The study surveys financial laws and regulations, with specific focus on how these affect the provision of financial services to the basic sector. The study covers laws and regulations relating to intermediation taxes, interest rates, mandatory loan allocation prudential regulations, bank entry and branching, deposit insurance, as well as those creating specialized government and non-government financial institutions including specialized banks and guarantee institutions. The study also reviews the role of guarantee schemes, non-financial government institution as well as non-government institutions and cooperatives in the microfinance market. Based on the results of the review, the study pointed out specific recommendations to improve and rationalize the credit policy environment. The necessary administrative and legislative measures are highlighted.
6. <i>Regulatory Barriers to Innovative Lending Services: Traditional Approaches to Bank Supervision</i>	<p>The study pointed that while there are no provisions of the law which mandate that small loans be secured and supported by formal financial statements, perception on the micro-lending environment differ greatly. Examiners and regulators ask for collateral and loan documentation requirements in evaluating the quality of the bank's loan portfolio. Lenders under the examiner's supervision, on the other hand, are unclear about the BSP's views on small clean loan supported by informal financial information. Hence, most banks are not inclined to engage in the delivery of microfinance services.</p> <p>In relation to this, the study pointed out that the current approach to bank examination in the Philippines only focuses on the primary or borrower-related risks associated with loans. Secondary or product-related risks are not taken into consideration. Since micro-lending has a unique risk-profile, the study recommends the use of risk-based management techniques in evaluating loan portfolio quality so as not to discriminate against small clean loans. The study also pointed out those internal barriers such as the lack of infrastructure for microfinance should also be addressed for effective adoption of risk management techniques. The study identified specific recommendations to address the perceived regulatory barriers for microfinance institutions.</p>
7. <i>Interest Rates, Subsidies and DCPs in the Philippines</i>	The study showed that the current interest rate structure of DCPs provide large subsidies to executing agencies to pay for their transaction costs and non-financial conduits

<i>Title of Study</i>	<i>Brief Summary</i>
	<i>(cooperatives, NGOs, self-help groups). Subsidies given to financial conduits and end-borrowers are relatively smaller. Programs directed to the poorer sectors are burdened with relatively large default subsidies while the rest of the borrowers appear to be paying interest rates that are relatively high and not so different from what they would have gotten without the credit program. Among other things, the study recommended that instead of stressing interest rate policies, it might be more appropriate to directly estimate the costs of financial intermediation and to focus on how DCPs affect these cost. This will make the costs of DCPs (which include costs of government subsidies and cost in managing the many lines of directed credit) more apparent.</i>
8. <i>The Impact of Mandated Credit Programs in the Philippines</i>	<i>The study pointed out that for the mandated credit allocation for agrarian reform, rural banks had the highest compliance ratio followed by commercial banks and thrift banks. Foreign banks have the lowest compliance ratio due to their limited market, which pose as a barrier in reaching the agrarian reform market. With regards to mandated credit allocation for Small and Medium Enterprises, thrift banks have the highest compliance rate followed by rural banks and commercial banks. Again, foreign banks have not consistently complied. The study also showed that mandated credit allocation increases the cost of funds, but it is not clear who bear this cost. The study also pointed out that since it might be politically costly to lift the mandated credit allocation, a market-based system of compliance to MCPs might instead be adopted.</i>
9. <i>Loan Guarantee Programs in the Philippines: The Dilemma of Sustainability and Outreach</i>	<i>The study assessed the performance of the three (3) loan guarantee programs in Philippines, namely: the Guarantee Fund for Small and Medium Sized Enterprises (GFSME); the Small Business Guarantee and Finance Corporation (SBGFC); and the Quedan and Rural Credit Guarantee Corporation (Quedancor). These programs were established to stimulate lending to farmers or to operators of small businesses. The study pointed out that the outreach of the various programs of the three (3) loan guarantee institutions has been disappointingly limited; that the programs are heavily dependent on subsidies; and most policy options that might increase program outreach will further worsen the sustainability and subsidy-dependence problems.</i>
10. <i>Case Study on the Best Practices of Government Non-Financial Agencies Implementing Directed Credit Programs</i>	<i>The study focused on two (2) relatively successful microfinance programs directly administered by non-bank government institutions – the Self-Employment Assistance – Kaunlaran (SEA-K) Program of the Department of Social Welfare and Development (DSWD) and the Pilot Revolving Credit Fund and Saving Scheme of the Central Cordillera</i>

<i>Title of Study</i>	<i>Brief Summary</i>
	Agricultural Programme (CECAP) of the Department of Agriculture (DA). The study found out that while the programs are able to provide credit to the poor, this entailed high fiscal costs on the part of the government. The high cost is due to the institution-building component of the programs and the zero interest rate charged to program beneficiaries.
11. <i>Review of the Regulatory Environment for Credit and Deposit-Taking Cooperatives</i>	The study reported that the Cooperative Development Authority (CDA), the agency mandated to regulate and supervise cooperatives, is not capable of supervising cooperatives adequately. Thus, it identified several measures that need to be adopted to improve government oversight over deposit-taking cooperatives. One of the key recommendations of the study is the establishment of the standard chart of accounts for deposit taking cooperatives.
12. <i>Development of the Microfinance Policy Framework for Agrarian Reform Areas</i>	<p>Recognizing that microfinance is an important tool for poverty alleviation and that it will complement their existing programs for support services to Agrarian Reform Beneficiaries, the Department of Agrarian Reform has expressed interest in promoting microfinance activities in the agrarian reform communities (ARCs). Given the current government credit policy framework and the government's National Strategy on Microfinance, it is important that programs designed by DAR for ARBs be consistent with and supportive of this policy framework. In view of this, DAR requested NCC with assistance from CPIP to develop the appropriate microfinance policy reform framework in agrarian reform areas.</p> <p>The study specifically formulated a policy and operational framework for microfinance in agrarian reform areas; identified specific policy and operational issues in various programs with credit component being implemented by DAR that need to be resolved to effectively implement the proposed policy and operational framework and identified specific policy and operational reforms that need to be executed by DAR in its various programs with credit component.</p>
13. <i>Conduct of a study that reviews the existing legal environment and identifies specific legal provisions that will make participation of financial institutions in the credit bureau more effective, e.g., ensure timely and accurate submission by all financial institutions of all credit transactions of borrower to the credit bureau.</i>	<p>The following study findings were reported and presented to the members of the Monetary Board:</p> <ul style="list-style-type: none"> ○ The BSP has the legal authority to establish and operate a credit information bureau as an internal unit within its organization. In the course of its operation, it may outsource part of its credit information activities, e.g., processing of raw credit information. ○ The BSP, in the exercise of its regulatory and

<i>Title of Study</i>	<i>Brief Summary</i>
	<p>supervisory powers, can require all its regulated entities to submit credit information to the BSP credit information bureau.</p> <ul style="list-style-type: none"> ○ The monetary board may prescribe specific policy guidelines for the release of credit information by the credit information bureau to BSP-regulated entities. These policy guidelines may include, among other things, the following: execution of borrower's consent to the submission of credit information to the Bureau and in turn to the release of such information to other BSP-regulated entities; other confidentiality measures, and ways to address erroneous information. ○ Inclusion of a borrowers' consent in credit loan application and agreements can be imposed on BSP-regulated entities through an exercise of BSP's policy-making authority. ○ To ensure submission of credit information by financial institutions that are not regulated by the BSP (e.g., credit cooperatives under the CDA and microfinance NGOs and financing companies under the SEC), a regulators' agreement maybe entered into by and between the BSP and the other regulators. Such agreement would, among other things, be uniform and specific and include confidentiality arrangements regarding the institutions' access to the information in the Bureau. ○ Entities accessing the Bureau in the BSP should enter into accreditation agreements with the BSP. Such agreements should include the terms and conditions for access to credit information in the database including, among other things, provisions on the allowed uses of the credit information, terms of confidentiality, and the rights of concerned borrowers.
14. Review of the rural finance sector	<p>The study reviews the existing policy environment for the rural finance sector in the Philippines. The review, among other things, looked into the implementation of the various credit policy reforms and determines the gaps in policy implementation. The various problems and issues that discourage financial institutions to provide rural financial services were also identified in the study.</p>



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Regulatory Barriers to Innovative Lending Practices: *Traditional Approaches to Bank Supervision*

Barriers exist. While there is nothing in the provisions of the law which mandates that small loans be secured and supported by formal financial statements, the study found that perceptions of the micro-lending environment differ greatly. This results in the lack of coherency and unity in the regulation of micro-enterprise lending. During bank examination, examiners and regulators check for compliance with banking laws, rules and regulations, soundness of systems for evaluating credit, supervision and collection of loans and the quality of the portfolio. They believe that they are reasonable in the approach they use to evaluate loan quality and in their collateral and loan documentation requirements. Lenders subject to BSP supervision, on the other hand, are unclear about the BSP's

views on small clean (unsecured) loans supported by informal financial information. The laws and regulations do not prohibit microenterprise lending but there is language in them that cause lenders to believe that to engage in such activity is operating on the periphery of the law. They are, therefore, afraid to make such loans for fear of being criticized by bank examiners. Oftentimes, bankers feel safer to avoid activities where there is so much subjectivity in evaluating their judgment. In view of this, clarification of law and regulations to address the peculiarities of micro-lending may make bankers feel more comfortable in exercising their judgment.

The current approach to bank examination in the Philippines focuses on

the primary or borrower-related risks associated with loans. Secondary or product-related risks are not consistently taken into consideration. While examiners are aware of the secondary risks, they do not develop risk profiles of individual products or services nor do they formally appraise risk management systems of the financial institution. Micro-loans are just another new and different product for which risks must be identified and evaluation frameworks designed and implemented. Micro-lending has a unique risk profile and requires unique management skills and support systems.

Internal barriers also exist. Formal lending institutions are not inclined to extend micro-loans because of the tremendous work involved in the origination, supervision, collection and recording of a large number of very small loans. Even if these costs can be covered by charging high interest rates, commercial banks and large thrift banks are still reluctant to enter the market due to the existence of sufficient demand for larger loans which generate good returns with less work per loan. Another barrier is the collective memory of previous bad experiences. Some borrowers involved in directed credit programs in the past view the money they receive as government grant and therefore, does not feel obligated to repay the loan.

The lack of appropriate infrastructure for microfinance operations (for both lenders and examiners) also pose as a barrier. Better management tools are needed to enable financial institution to better respond to micro-enterprise customer needs. A micro-finance institution must manage a very large portfolio of small loans to be profitable and competitive. The only way to manage the loan portfolio effectively and to generate the information that is needed to manage risk is through the use of computer-based information systems. The most critical is the loan portfolio management system which tracks all activity on all outstanding loans, will permit the rapid identification of potentially troubled loans, and will provide an effective basis to evaluate borrower performance over time. This system will also facilitate portfolio analysis and evaluation by examiners.

Section 25 of RA 337, limits investments in bank premises and equipment to not more than 50 percent of net worth. Since no implementing guidelines have been issued yet, the BSP should consider excluding computer equipment from the ceiling, provided computer hardware is used primarily for banking purposes. This is especially crucial for those MFIs who have small capitalization.

RECOMMENDATIONS

In view of the foregoing, the following recommendations are submitted for the consideration of appropriate government agencies:

- Dialogue with banks and other organizations espousing micro-lending to clarify BSP supervision policies and laws, rules and regulations.
- Modifications of laws and regulations to better reflect current policy
- Better understanding of risk management techniques
- Assistance to rural banks and thrift banks with head offices outside of cities and first and second class municipalities in developing computer applications for loans and in servicing computer hardware.
- Removal of investments in computers and ceilings on bank premises and equipment
- Strengthening BSP supervision over micro-loan portfolios
- Assistance to the Bangko Sentral ng Pilipinas (BSP), Cooperative Development Authority (CDA), and the Philippine Deposit Insurance Corporation (PDIC) to enhance their capabilities in supervising institutions engaged in micro-lending.
- Changes needed to the Law for PDIC and BSP to carry out their missions
- NGOs should establish thrift rural and cooperative banks, non-stock savings and loan associations or credit unions
- Moderate negative perceptions associated with charging the poor the higher interest rates required to do micro-lending on a self-sustaining basis
- Establishment of formalized micro-enterprise lending programs

Based on a report prepared by Thomas M. Fitzgerald, Feliciano L. Miranda, Jr., David S. Murphy and Gerald S. Schulz, Consultants.

For further information, please contact

**National Credit Council Secretariat
Department of Finance**

Undersecretary Ma. Cecilia G. Soriano, Ph.D
Ma. Teresa S. Habitan
Joselito Almario
Ma. Lourdes Dedal
Aurora Luz Villaviray
Febe Lim
Erick Tipgos
Nelvia Lansang

*Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287*

**Credit Policy Improvement Program
Project Management Office**

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo
Amor H. Colina

*7th Floor, EDPC Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone Nos: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph*



National Credit Council

Policy Notes

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Assessment of the Role and Performance of Government Non-Financial Agencies in Implementing Directed Credit Programs

Introduction

Directed credit programs (DCPs), as defined by the National Credit Council (NCC), are those programs directed toward a specific sector whose funds either come from budgetary allocations or official development assistance from bilateral or multilateral donor organizations in the form of grants or loans. DCPs are generally implemented by the government as tools in making credit available to target beneficiaries and to institute some reforms in targeted sectors. These programs also have varying objectives including, among others, supporting the growth of the agriculture sector, promoting the expansion of small and medium enterprises, providing employment and livelihood opportunities, increasing incomes of target beneficiaries or restructuring a specific sector.

In the past, DCPs focused primarily on effectively reaching their target borrowers, and only secondarily on the efficiency of the programs. Consequently, many of the DCPs had not been financially sustainable and failed to reach their target borrowers.¹ In particular, DCPs implemented by government non-financial agencies (GNFAs) are seen to be more inefficient

due to the relatively high administrative expenses aggravated by poor collection and monitoring systems. Furthermore, these agencies not only suffer from lack of staff capable of handling credit evaluation, monitoring and collection, but they also have difficulty resisting intervention from politicians in their credit judgments.²

There is a growing concern among policymakers about the distortions that DCPs might have introduced into the financial markets. Moreover, they are increasingly worried about the substantial amount of government resources that DCPs have used up that otherwise could have been used for other development programs that can clearly and surely bring more benefits to the Philippine society. The issue of outreach and efficiency of the DCPs has been given increased emphasis.

¹ Lim, Joseph and Dale W Adams, "Interest Rates, Subsidies, and Directed Credit Programs in the Philippines," *Credit Policy Improvement Program Paper* (26 September 1997).

² "Policy-Based Directed Credit Programs in the Philippines". *The Research Institute of Development Assistance (RIDA), The Overseas Economic Cooperation Fund (OECF), Tokyo, Japan, January 1995.*

Are the DCPs able to reach a large number of its target borrowers? Do they recover loans, along with interest charges and fees, so that they can re-lend the funds to those that have been waiting in line for loans and so that its loanable funds will not be dissipated?

General Profile of the 37 DCPs

The 37 DCPs covered by the study are being implemented by 13 government non-financial agencies (GNFAs) mainly for the sector which they are mandated to serve. Only 4 out of the 37 DCPs are purely credit programs. The majority (24) of the DCPs are lending programs that have other components including the provision of technical assistance to their target clients.

Seventeen (17) of the DCPs have identified the farmers, fishers and rural workers in general as the end-users of the loans they provide. Low-income or poor communities and/or disadvantaged groups (women, youth and the disabled) have been targeted as the beneficiaries of 7 DCPs. Another 7 credit programs are available principally to develop various types of cooperatives including cooperative banks and other people's organizations. Four (4) DCPs cater to inventors while one program is available to benefit trade unions and laborers. Small and medium entrepreneurs can tap at least 3 programs of the DTI for their financing needs.

The majority (29 or 80%) of the DCPs obtain funding solely from local sources. The remaining 8 DCPs utilize loans or grants obtained from foreign sources such as ADB, OECF and the EEC.

Most, if not all, DCPs started operations after 1986. Hence, the longest running credit programs are now 9 years old. However, on the average, these credit programs are in operation for about 5 years.

Twenty-six (26) of the DCPs are available to target clients nationwide. About 8 programs are in operation only in selected provinces, primarily in the poorest provinces in the Social Reform Agenda (SRA) as well as in the DA's Key resource Areas. The remaining 3 programs have much more limited area coverage.

DCPs Modes of Credit Delivery

Twelve (12) of the 37 DCPs have utilized the direct mode of credit delivery. Five of these 12 DCPs lend directly to cooperatives, NGOs and other institutional borrowers for a common project/undertaking, while 7 DCPs lend directly to individuals.

Twenty five (25) of the 37 DCPs have used the indirect mode of credit delivery, although the type of financial intermediaries tapped may vary. Of the 25 DCPs, 5 have employed fund administrators as financial intermediaries, 13 utilized conduits (cooperative, NGOs, and other people's organizations), and the remaining 7 used both types of financial (credit) intermediaries.

Three (3) out of the 12 DCPs employing the direct mode of lending provide end-users interest-free loans. The rest charge interest on individual loans ranging from 6-18 % per annum and on cooperative loans, 6-14% per annum.

Most DCPs utilizing the indirect mode provide funds without charges to financial intermediaries, especially fund administrators. However, lending rate to end-users are prescribed not to exceed 18% per annum.

Fund administrators/lending conduits which are paying interest on loans from GNFA's are most free to determine the rates they will charge on loans to end-borrowers.

Productivity, Outreach and Efficiency of DCPs

Productivity ratios of DCPs in terms of loans granted and loans outstanding vary among programs. Among the 31 DCPs with complete data, the productivity measured in terms of number of loans granted per personnel ranged from less than 1 to a high of 312. In terms of volume, loans granted per personnel ranged from P60,000 to about P21 million per annum.

DCPs with high productivity ratios are seen to handle huge portfolios of small-sized loans or long-term loans with relatively short repayment periods. Further, there are no significant differences in productivity of DCPs using the direct or indirect mode.

In general the productivity ratios of the DCPs are deemed low compared with those of rural financial institutions in other countries which average from 120 to 272 loans granted per personnel per annum. This implies that the DCPs implemented by GNFAAs have not achieved significant levels of outreach and have low staff efficiencies.

The outreach and efficiency of each of the 37 DCPs has been assessed through the use of an outreach index (OI) and a cost recovery index (CRI) developed for the purpose. The outreach index (OI) determines whether the DCP reached its target and potential number beneficiaries and the cost recovery index (CRI) measures the degree of efficiency of a DCP. A DCP has high outreach if the computed OI

is equal to or greater than 1; it has low outreach if the computed EO is less than 1. A CRI that is equal to or greater than 1 indicates that the DCP being investigated is efficient; otherwise, it is inefficient. An efficient DCP must, at the very least, recover its total costs. If the DCP recovers only its administrative cost and risk-induced cost, then it is considered only operationally efficient.

Given the measures of outreach and efficiency, a DCP being examined may fall in any one of the following four combinations: (1) with low outreach and inefficient; (2) with high outreach but inefficient; (3) with low outreach but efficient; or (4) with high outreach and efficient. Table 1 summarizes the results of the DCP assessment based on the outreach and efficiency measures.

OUTREACH AND EFFICIENCY OF DCPs			
	LOW OUTREACH		HIGH OUTREACH
INEFFICIENT	1		2
	DA/ACPC - IRF ¹ ² DOST - IDAF ¹ DAR CDA - CMP ² - CDF/CIA ² ¹ DOLE/BLR - WEP ¹ DOLE/BLE - Tulay 2000 ² DTI/BSMBD - AMEDP ² - CIF ¹ - SLP ² - TST-CPPP ²		DA/BAI - MLDLP ² - CARM-BMC ² - KMI PDF ² - DBP FP for ARBs ² DA/ACPS - ECBAP ² - 5-25-70 CPS ² - Micro Credit ² - FSP ² - Gintong Ani ² - DAPCOPO ² DA/NAFC - LEAD 2000 ¹ DA/SCO - SMAP ² - CECAP ² CDA - CDLF ² ¹ - CRDLF ¹ - CSF ¹ DOLE/BRW - PRESEED ² DOLE/BWYW - WWEDP ² DSWD - SEA-K ¹ DTI/BSMBD - TST-MCP II ² - MEDP-CDF ²
EFFICIENT	3		4

Note: 1 - using direct mode of credit delivery
 2 - using indirect mode of credit delivery
 * - operationally efficient

24 out of the 37 DCPs with complete information were evaluated

Thirteen out of 15 programs catering to the agriculture and rural sector with complete data are able to reach their target and potential number of borrowers. These DCPs include DA's Lead 2000, CECAP, DAPCOPO, SMAP, ECBAP, FSP, Gintong Ani, ACPC-LBP CPS and MLDLP; DAR's DBP FP for ARBs, CARP-BMC and KMI-PDF; and DOLE's PRESEED. Only IRF and CMP have outreach indices which is less than one.

For the poor/disadvantaged sector, 5 out of 7 DCPs are found to have reached their target and potential beneficiaries. Those which failed to reach their target and potential beneficiaries include Tulay 2000 of DOLE and SLP, AMEDP and CPPP of DTI. The TST NGO/MCP in the SME sector has been reaching its target clientele satisfactorily while the CIF fared poorly. The WEP, which caters to the labor sector, is not satisfactorily reaching its target clientele. Out of the 4 DCPs catering to various sectors, CDLF, CRDLF and CSF have high outreach indices. The CDF/CIA remains to have poor outreach.

The findings on the outreach of DCPs have the following implications:

A. The mode of credit delivery does not have a very significant impact on the outreach of the DCPs considering that some programs which employ intermediaries are not able to reach their target clientele while others which directly lend are satisfactorily reaching their ultimate borrowers. The use of intermediaries with mass-based members or clients, however, could broaden the outreach of the DCP. This also confirms the deduction that GNFA's use intermediaries to ensure broad-based implementation of their programs

B. The outreach indices are higher for DCPs whose intermediaries belong to the targeted sector and which are also beneficiaries of funds as in the case of PRESEED, WWEDP and WEP.

C. Locally supervised and area-based programs such as the SEA-K, SMAP and CECAP, are highly effective in reaching target and potential clientele because borrowers are directly identified and supervised by program staff at local level.

D. DCPs funded out of congressional initiatives such as SLP, AMEDP and CDF/CIA may not be satisfactorily reaching their ultimate borrowers because some of the clients are reported to be preselected or identified and may not necessarily belong to the target sector. Relatedly, the poor access to these programs by those who truly belong to the target sector results in untapped funds. Accordingly, there is only a small number of borrowers relative to what the program can actually support.

E. The poor capacity of borrowers to meet requirements and come up with good proposals have an impact on the effectiveness of DCPs as reported by SMAP, CARP-BMC, KMI-PDF, CMP, CIF, WEP and the DOST programs.

Total program costs comprising administrative expenses, risk-induced costs, costs of borrowed funds and costs of equity capital with respect to the DCPs' operations during the period 1994-1997 averaged at least 13 centavos per peso of loans outstanding. By mode of credit delivery, DCPs using the direct mode incurred, on the average, 5 centavos more or on aggregate of roughly 19 centavos per peso loan. Those lending directly to individuals incurred even bigger cost of at least 22 centavos while those lending directly to cooperatives spent a lower amount of about 17 centavos per peso loan

The bulk of expense of the DCPs, particularly those that employ the indirect mode of credit delivery, went to the cost of equity capital. On the other hand, DCPs that lend directly to individuals have bigger operational costs.

RECOMMENDATIONS

The following enumerates the disadvantages of GNFA's in implementing directed credit programs that far outweigh whatever informational advantages they have in lending to their targeted borrowers.

- A. There is no firewall between the managers of the credit programs, on one hand, and the bureaucrats and politicians, on the other hand, within the same agencies, thereby making it very hard to secure managerial independence for the former, which is one of the hallmarks of successful credit programs of high performers in East Asia.
- B. It is very difficult to formulate and follow objective performance criteria for the credit programs when these credit programs are considered only a supplementary tool to some of the primary activities of the agencies. This is probably the reason why GNFA's put emphasis only on the effectiveness of their DCPs. When the loans made by the banks turn sour, these will inevitably show up in their balance sheets and will clearly undermine their ability to continue their lending operations. The case of GNFA's is different. GNFA's do not have balance sheets and they are not transparent in public. Unlike banks, GNFA's are not subject to supervision by any of the supervisory bodies in the country. Failure of the credit program would not incapacitate a regular non-financial government agency because its main functions are regularly supported by the national budget.

- C. The GNFA's typically lack the capacity and also the motivation to build capacity necessary to manage credit programs well because of the constraint they face in designing good incentive systems for their staff. The relatively high turnover of staff hampered not only the maintenance of a good record system for credit transactions but also all aspects of credit delivery — from screening to monitoring of loan collection.
- D. GNFA's have very limited capability to acquire additional information about their clients for credit-risk assessment, which banks can do through other financial services, such as deposits, which they offer to their clients.

On the basis of the above arguments and the compelling results, it is recommended that the government spell out a clear policy prohibiting non-financial government agencies from implementing directed credit programs. The informational and cost advantages that have been used to justify GNFA's entry into the credit market are not clearly supported by the results of the study. GNFA's should focus on their primary functions and leave credit function to financial institutions. The government should give strong signals to government financial institutions indicating the sectors that need to be supported, but leaving the selection of individual borrowers to the financial institutions.

Based on a report prepared by Mario B. Lamberte, Magdalena S. Casuga and Doreen Carla E. Erfe, Consultants.

For further information, please contact

National Credit Council Secretariat Department of Finance

Undersecretary Ma. Cecilia G. Soriano, Ph.D
Ma. Teresa S. Habitan
Joselito Almario
Ma. Lourdes Dedal
Aurora Luz Villaviray
Febe Lim
Erick Tiggos
Nelia Lansang

*Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287*

Credit Policy Improvement Program Project Management Office

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo
Amor H. Colina

*7th Floor, EDPC Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph*



National Credit Council

Policy Notes

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Interest Rates, Subsidies, and Directed Credit Programs in the Philippines

Do directed credit programs (those made mandatory through legal issuances) serve the purpose of stimulating economic growth? How do they affect the financial system? How much does the government spend in subsidies for these programs? Who makes use of these subsidies, and who ends up paying for them? Do end-borrowers avail themselves of low-interest loans through these programs?

A recent study (Llanto et al 1997) of the top 20 directed credit programs, out of the current 86, suggests the following:

- The government incurs large expenses in terms of interest and default subsidies. In 1996, they amounted to P1.897 billion (for the 20 programs). The bulk of these subsidies is used by government agencies executing the directed credit programs, and by their non-financial conduits (cooperatives, NGOs, self-help groups) catering to farmers, fisherfolk and microenterprises, to cover administrative and op-

erating expenses, transaction costs, and defaults on payments.

- Since many targetted borrowers default on their payments, the directed credit programs are burdened by large default subsidies, which indicates that these programs may not be really that effective in improving the lot of the poor.
- Since directed credits do not follow one market rate, many end-borrowers (those not in the poor category) pay interest rates that are relatively high and not so much different from what they would have gotten without the credit program.
- Directed credit programs weaken the financial system through infusion of more costs into the system and by discouraging the mobilization of deposits through the presence of rediscounting facilities or loanable funds with very low interest rates.

Subsidized credit: a background

In the 1970s and 1980s, some governments were forced to eliminate directed credit due to the burden of paying for the interest rate subsidies and for loan defaults. Subsidized credit programs were also criticized for being ineffective in easing poverty, for their adverse effects on investment and production decisions, and for weakening the ability of financial markets to act as intermediaries between savers and borrowers. There were also serious problems of loan recovery, troubled banks and overall economic stress. In the Philippines, the most classic example of failure of directed credit is the Masagana 99 program of the Marcos administration.

In the late 1980s, major funding institutions, including the USAID and the World Bank, considered directed credit to be ineffective in boosting development efforts. Besides, it ran counter to the new economic development paradigm that relied on market forces instead of central planning.

However, studies (Lamberte 1992; Llanto et al 1997) showed that directed credit even expanded, although the amount of subsidies generally shrunk. There were 86 directed credit programs in 1997 compared to only 68 in 1992.

Of the 86 programs, only 26 provided data on their loan balances as of end 1996, totaling P37.2 billion. In his study, Llanto focused on the top 20 programs based on new loans they disbursed in 1996, which amounted to P14.41 billion. Seven of the programs, which accounted for 12.3 percent of the loans released (for the 20 programs), were funded by the national government through letters of instructions, executive orders, republic acts, and rediscounting windows of the former Central Bank.

The 13 other programs, which accounted for 87.63 percent of the loans released, were funded by foreign multilateral agencies: the World Bank, Asian Development Bank, Overseas Economic Cooperation Fund, and the Export-Import Bank of Japan.

The biggest repositories of funds for directed credit programs are the Development Bank of the Philippines (DBP) for industrial and manufacturing enterprises, and the Land Bank of the Philippines (Landbank) for agriculture-related projects. The Department of Agriculture and the Agricultural Credit and Policy Council (ACPC) also hold considerable funds for integrated rural financing, the fisheries sector, and the food security and production programs.

Results of the study on the 20 programs

- I. Directed credit programs incur large amounts of subsidies. In 1996, the subsidies for the 20 programs amounted to at least P1.897 billion, consisting of P1.39 billion in interest subsidies and P507.3 million in default subsidies. The subsidies are mainly to fund administrative and operating expenses and transaction costs of agencies involved in directed credit programs. Large interest and default subsidies are incurred primarily by programs with a lot of subsidy layers (from executing agency to conduits to end-borrowers).

Interest subsidies are given to non-financial conduits (NGOs, cooperatives, self-help groups) supposedly because these conduits provide direct benefits to the needy and low-income groups. Default subsidies are concentrated in a few programs with high default rates, mainly for

small rural borrowers and owners of microenterprises. It is understandable for the poor to incur more defaults, but this points to the limitation and obstacles of using credit subsidies to improve the lot of the poor:

2. Of the 20 programs, 12 provided credits through conduits, or participating financial institutions. But these institutions were expectedly unenthusiastic about the programs because most of the interest rates charged were close to deposit and T-bill rates, providing them little subsidy to cover for costs of transactions and paper works.
3. Seven programs channeled credits through co-operatives, NGOs, credit unions, or self-help groups, mostly for farmers, fisherfolk and microenterprises. Subsidies for these seven programs amounted to P261.4 million, representing 13.8 percent of total interest and default subsidies of the 20 programs. The rationale for this was that since these conduits give more direct benefits to the needy, they should have more subsidy. Whether this is right or wrong is an empirical question, but large subsidies could open the funds for misallocation and misappropriation.
4. Only six of the programs—four for agricultural and rural producers, one for modernization of shipping fleet, and one for small and medium enterprises—gave subsidized interest rates to end-borrowers amounting to a modest P153.3 million, just slightly more than the interest subsidies to financial conduits. They comprise 10.3 percent of total interest subsidies for the 20 programs.

While the poor borrowers are subsidized for defaults, other final or end-borrowers are imposed

“market rates of interest.” Actually these should be more appropriately called “cost recovery rates.”

Overall, it remains question whether or not the costs generated by directed credit programs are commensurate to the benefits derived from them. Some estimates indicate that the entire amount of loans released to the 20 credit programs (P14.4 billion in 1996) has an opportunity cost amounting to at least P850 million, which could have been earned by putting the money in treasury bill or time deposits. Thus, it may be asked: Did the credit programs generate the same amount of earnings? Are the subsidies necessary and worth the benefits derived from the credit programs? More studies are needed to answer these questions.

Effect on the financial system

A major criticism against subsidized and directed credits is that they discourage deposit mobilization, thereby weakening the ability of the financial system to assist in allocating resources more efficiently. For example, a rural bank with access to a rediscounting facility or loanable fund that pays only 4 percent will not be enthusiastic about mobilizing deposits on which it must pay higher interest rates. Thus, funds carrying concessionary interest rates may have an adverse effect on deposit mobilization.

Administrative and transaction costs generated by directed credit programs in the Philippines have not been documented, but research in other countries shows that these costs are substantial. There are indications that these costs constitute the biggest component of the subsidies, and this component usually goes to executing agencies that manage the directed credit programs.

R E C O M M E N D A T I O N S

1. Evaluate the directed credit programs to determine if the benefits derived from them are worth more than the costs. The evaluation must also determine which of the credit programs have higher costs than the perceived benefits, so that policy makers may decide whether the programs can be improved to make the benefits surpass the costs, or whether to phase out the programs.
2. Rationalize the entire system and institutions of directed credit programs so that some amount of subsidies may be freed for other vital projects. This means higher interest rates may be charged on loans, and the higher proceeds may be used for other projects. The rationalization can be in the form of pooling and consolidating similar programs into one institution. Thus, the agricultural and rural loans of the DA, ACPC, NLSF, PCFC and Quedancor can be pooled and consolidated with those of the Land Bank of the Philippines to save on administrative and operations costs. The same may be done for the loans provided to small borrowers by the Bureau of Small and Medium Enterprises and by the Development Bank of the Philippines.
3. Undertake studies to determine if the interest subsidies to conduits and end-borrowers have corre-

sponding benefits. One study should verify if interest subsidies discourage deposit mobilization and jeopardize the sustainability of the conduits by making them dependent on subsidies. Other studies should show whether subsidies to end-borrowers are justified in terms of viability and sustainability, and whether the default subsidies (the second biggest component of total subsidies to directed credit programs) should continue, considering that they could encourage non-payments, which could lead to a repeat of the experience in the 1970s and early 1980s, when the credit programs collapsed.

4. Instead of stressing interest rate policies, it might be more appropriate to estimate the cost of financial intermediation and to focus on how directed credit programs affect these costs. This is to make more apparent the costs of the programs, including the costs of subsidies and of the credit lines.
5. Conduct research to estimate the subsidy-dependency indices for directed credit programs and their institutions, to see if these measures are useful in rationalizing the system of directed credit programs.

*Based on a report prepared by Joseph Lim
and Dale W Adams, Consultants.*

For further information, please contact

National Credit Council Secretariat Department of Finance

Undersecretary Ma. Cecilia G. Soriano, Ph.D
Ma. Teresa S. Habitan
Joselito Almario
Ma. Lourdes Dedal
Aurora Luz Villaviray
Febe Lim
Erick Tiggos
Nelia Lansang

*Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287*

Credit Policy Improvement Program Project Management Office

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo
Amor H. Colina

*7th Floor, EDPC Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph*



National Credit Council

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Impact of Mandated Credit Programs on Financial Institutions

As a development policy, the government mandates all banks to set aside a portion of their loan portfolio for: 1) the agriculture and agrarian reform sector; and 2) the small and medium enterprises. The laws covering these mandates are the Agri-Agra Law (P.D. 717) and the Magna Carta for Small Enterprises (R.A. 6977) of January 1991, amended in 1997 to include medium enterprises.

Under the Agri-Agra Law, banks are required to allocate at least 25 percent of their loanable funds for agricultural credit — 10 percent for agrarian reform beneficiaries and 15 percent for general agricultural loans. The former Central Bank limited the interest rate to 12 percent per annum, and the service fees and other charges to 2 percent or P150 per annum.

Under the Magna Carta, all lending institutions are required to set aside a part of their loan portfolio for credit to small enterprises according to the following schedule: at least 5 percent by end of the first year of the effectivity of the law, 10 percent

by end of the second year (1992) to end of the fifth year (1995), 5 percent by end of the sixth year, and zero by the end of the seventh year.

The law was amended by R.A. 8289 in May 1997 to extend it until 2007, and to include the medium enterprises in the allocation, since under the original law the loans to medium enterprises were only encouraged, not mandated. The new law set aside 8 percent of the loan portfolio—6 percent for small and 2 percent for medium enterprises.

Compliance with Mandated Credit for the Agri-agra Sector

As of March 1997, banks have provided P117 billion in credit to the agricultural sector. Commercial banks lent out P104 billion or 89 percent, thrift banks P7.3 billion or 6.3 percent, and rural banks P5.6 billion or 4.8 percent. However, total bank loans were P55.2 billion below the mandate, or only 17 percent instead of the 25 percent mandated by law.

For agrarian reform credit, rural banks had the highest compliance ratio (the ratio of utilized fund to total loanable funds generated) of 10 percent, followed by commercial banks with 1.8 percent, and thrift banks with 0.5 percent. Among commercial banks, foreign banks have the lowest compliance ratio because, with their limited number of branches, they cannot access the agrarian reform market. For agricultural credit, commercial banks had a compliance ratio of 17.2 percent, and rural banks 15 percent. Thrift banks were unable to comply.

During 1975-1996 total loanable funds grew at an annual rate of 18.7 percent, but agri-agra loan compliance grew only by 15.5 percent (or 7.9 percent annual growth for agrarian reform loans and 15.4 percent for agricultural loans).

Rural banks seem to be best suited to provide loans for the agriculture sector; but since they generate the smallest amount of loanable funds, they do not create an impact.

Compliance with Mandated Credit for SMEs

As of June 1997, the banking system has allocated almost 13 percent of its loan portfolio for credit to SMEs, which is 5 percent more than the mandated minimum of 8 percent. Thrift banks have the highest compliance rate at 26.13 percent, followed by rural banks at 17.02 percent, and commercial banks at 11.22 percent. Foreign banks have not consistently complied. About 86 percent of their utilization was in the form of "due from the BSP," which were not actual funds lent out but only set aside for future loans.

Loans to SMEs have been growing faster than the loan portfolio. From 1991 to 1996, the loan

funds for SMEs grew by an average of 33 percent annually, while the actual loans provided grew by 51 percent.

Monitoring of Compliance to Mandated Credit

The BSP is tasked to monitor compliance of the banks to the mandated credit programs (MCPs), but the general perception is that this is not being done. At present, BSP does not even receive compliance reports from all banks. For example, as of June 30, 1997, only 741 (or 76 percent) of the 979 operating banks submitted reports on SME credit. Most of the non-reporting banks were rural (222) and thrift (16) banks.

There is a general perception that enforcement of the agri-agra mandate is weak, that the government is not pushing very hard. This may not be surprising since the government itself has a backlog in the implementation of the agrarian reform law.

However, there is also concern that strict enforcement of the MCPs might increase the operating costs and affect the financial soundness of some banks, especially the "niche" banks that cater to a narrow spectrum of borrowers.

Bank Response to Mandated Credit

MCPs increase the cost of funds, but it is not clear who bear this cost. It may fall on depositors (in terms of low interest paid to them), banks (in terms of reduced profit), or borrowers who do not necessarily benefit from the MCPs. Since every loan must be able to pay for marginal cost of funds and default costs, banks must make extra margin on loans that increase penalties, but should take negative margin on loans that reduce penalties.

Depending on the size or amount of cost, a small bank will have to choose the sector it will enter. If the market is thin or information-intensive, it will choose to become a “niche” or “boutique” bank, catering to a narrow spectrum of borrowers. This seems to be the case with thrift banks that lack scale economies to gather deposits. But risk pooling or information cost of lending will force the banks to become large or to specialize.

Foreign banks, since they are restricted by law to operate only a few branches, cannot develop an effective information and screening system, yet they are required to lend to hard-to-reach sectors.

At any rate, specialized and small banks must assume uneconomic operating costs or higher default costs to satisfy the MCPs. But since they do not seem to have much higher operating and default costs, it could only mean that MCPs are not strictly enforced.

Simulations indicate that banks generate inferior cost-adjusted returns on MCPs; thus, MCPs serve to erode the expected revenue stream of banks. To compensate for this erosion, banks have to raise loan rates, which means that the intended MCP recipients and/or the borrowers not under an MCP bear the cost of legislated lending. This also means that MCPs increase the effective cost of fund (ECF).

This increase reflects a fundamental increase in the riskiness of the banks’ portfolio as a result of the expectation that MCPs generate inferior cost-adjusted returns. However, banks may choose not to increase the rates of the pre-allocated funds for MCPs, but they have to calibrate their loan rate on the unencumbered funds so that the effective cost is at least recovered. Thus, the ECF becomes the minimum loan rate on unencumbered funds which

banks must effectively hurdle.

Based on the premise that default rates geometrically increase as loan rates rise, simulations indicate that the trade off between higher loan rates and higher default rates may lead to a “J-curve” phenomenon (see Charts).

Conclusions and Policy Implications

Thrift banks and foreign banks have lower rate of compliance with MCPs. Enforcement of MCPs is weak and penalties for non-compliance have not been imposed.

However, it could be a blessing that the banks have not been follow the mandated allocations, otherwise there would have been increases in default costs and operating costs, which could be dead-weight losses or costs that will have to be borne by the banks (in terms of lower profits), depositors (in terms of lower interest rates) and borrowers (in terms of higher lending rates).

Some bankers and financial managers consider the MCPs as a nuisance and should be better scrapped. This, however, forgets the fact that there are borrowers who deserved to be helped by this kind of legislation. The better option may be to convince Congress to upgrade the law and make it more binding.

Financial institutions are not averse to risks per se, but to risks that they cannot effectively manage. The difficulty with the present system is that the requirements are absolute for all types of banks even when some banks, especially the larger ones, are weak on the MCP target markets. MCPs turn out to be costly for both the banks and their clients because a unilateral credit decision was made for all types of financial institutions.

1. A market-based system of compliance with MCPs may be developed to lower the transaction costs for banks that are weak on MCP markets. This may be done by allowing financial institutions that exceed their mandated percentages to market their excess to institutions that fall short on the compliance requirement. This will enable institutions capable of intermediating in MCP target markets to use their comparative advantage while minimizing pressure on other institutions to take credit risks in markets where they have little expertise.
2. Institutions with capability to take direct credit risk may be allowed to directly float instruments in a primary market and use the proceeds for MCP target markets. Institutions not competitive in these markets can opt to purchase the instrument directly as a mode of compliance. A secondary market must be in place to make the instrument tradable between financial institutions, and to reflect the proper market price of the instrument and to generate sufficient liquidity.

3. Caution must be observed in putting up a penalty system for undercompliance. Too stringent penalties can have adverse impact on loan rates and could push banks to fudge on their accounts, putting great burden on the BSP auditors. If penalties are reasonable, they can be implementable and there is a better chance that institutions will maintain a better accounting of their transactions.

On administration, a consultative group composed of key government agencies may be considered. For MCPs, the group may include the DA, DAR, SMED Council, NEDA, BSP, DOF and DTI. It can be tasked with determining in advance the amount of credit needed for overall rural development. Among the advantages of this group is that credit targets can be set consistent with government objectives, and the focus of MCPs can be shifted from direct lending to individual borrowers to activity financing for rural support system such as infrastructure and post-harvest and storage facilities.

Based on a report prepared by Felipe M. Medalla and Johnny Noe E. Ravalo, Consultants.

For further information, please contact

**National Credit Council Secretariat
Department of Finance**

Undersecretary Ma. Cecilia G. Soriano, Ph.D
Ma. Teresa S. Habitan
Joselito Almario
Ma. Lourdes Dedal
Aurora Luz Villaviray
Febe Lim
Erick Tiggos
Nelia Lansang

*Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287*

**Credit Policy Improvement Program
Project Management Office**

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo
Amor H. Colina

*7th Floor, EDPC Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph*



National Credit Council

Policy Notes

JUNE 1998

NO. 98-05

Microfinancing for the Poor; *Experiences by Government Non-bank Agencies*

Is it feasible to extend small credit to the poor or disadvantaged groups through government non-bank institutions? Are community-based microfinance programs initiated by the government effective tools for alleviating poverty?

Experiences of two relatively successful microfinancing programs administered by two government departments suggest that the poor can be good credits risks if there are mechanisms to screen, monitor and enforce program policies and procedures. They also suggest that community organizations and officers can be good conduits for disbursement of funds.

These two microfinancing programs are the Self-Employment Assistance-Kaunlaran (SEA-K), started in 1992 by the Department of Social Welfare and Development (DSWD), and the Pilot Revolving

Credit Fund and Saving Scheme, started in 1993 by the Central Cordillera Agricultural Program (CECAP) of the Department of Agriculture. The programs aimed to help beneficiaries start their own micro-enterprises.

SEA-K Program Experience

SEA-K was implemented through SEA-K Associations (SKAs). An SKA was composed of five or six groups; each group had five individual members. The DSWD dealt with SKAs, which in turn dealt with members. An SKA could avail itself of seed capital assistance of not more than P150,000, interest free, for relending to members. Individual loan, also without interest, averaged P6,000. Some SKAs imposed a 10 percent service fee. Cost per peso of loan granted was P0.10, lower by P0.06 compared to Grameen Bank's P0.16.

Individual borrowers pay weekly amortization to SKA, which in turn repays the DSWD monthly. The collection is deposited in a bank and forms part of a “revolving and settlement fund” that may be reloaned. Across beneficiaries nationwide, women registered a 90 percent repayment rate, all others from 83 to 93 percent. The rate of loans unpaid to total loans outstanding is from 10 to 17 percent.

SKAs guaranteed the loans of members, but they implemented a system of incentives and sanctions to develop discipline. For instance, failure of a member to repay could mean disapproval or non-release of the loans of other members of his group. Each group was required to participate in savings mobilization to build up funds for equity capital, operating expenses and emergency. The savings contributions were also remitted weekly and were deposited in a bank. The beneficiaries were able to save almost P52 million, representing 50 percent of the expected savings to be mobilized from them.

As of June 30, 1997, 3,461 SKAs representing 77,470 individual members in 16 regions (including the Cordillera Autonomous Region, Caraga, and ARMM) have been assisted by the program. About P292 million in seed capital was released to SKAs. Of this amount, some P33 million was reloaned to 13,000 women, P12 million to 3,000 scavengers, P3 million to out-of-school youths, street children and persons with disabilities, and the rest to other members—poor families, single parents, senior citizens, and the unemployed.

CECAP Credit Program Experience

The CECAP credit program, on the other hand, provided financial services to poor households in remote barangays of the Central Cordillera. Since the banks declined to act as conduits, credit was disbursed and payments were collected through the barangay development officers (BDOs). Average loan, with fixed 12 percent interest, was P3,345 per borrower. Cost per peso of loan was high at P0.30 due to overhead costs.

Funds were delivered to village groups or associations composed of 15 to 20 members. The BDOs identified the priority barangays. Beneficiary groups, including field staff members and credit officers, were required to undertake training on procedures, team building and leadership to prepare them for program participation. Beneficiary groups were encouraged to put up a savings fund through voluntary savings, fines for tardiness or absence during meetings, and income from activities like benefit dance and raffle draws.

From 1993 to 1995, the program disbursed P8.5 million to 124 group projects with 2,549 beneficiaries. Payment of amortization was required weekly, or within five working days. Repayment rate was high at 95 to 98 percent during the first year, but fell to 88 percent in 1996 and to 71 percent as of August 30, 1997, due to problems in the implementation of micro-projects. Of the P8.5 million disbursed, P6.6 million fell due, of which P4.8 was collected and almost P2 million was unpaid and past due.

Assessing the Programs' Effectiveness

In terms of reaching intended beneficiaries, SEA-K has an effectiveness index of 3.68 and CECAP 1.96 (Lamberte, Casuga and Erfe 1997). This means SEA-K has reached nearly four times, and CECAP twice, the estimated number of potential beneficiaries. This is attributed to the network of social workers for SEA-K and BDOs for CECAP who served the target beneficiaries. In this sense, community associations and community-based development workers can be effective conduits or facilitators of credit funds.

Repayment rates were reported at 90 percent for SEA-K and 71 percent for CECAP. The programs also generated savings, indicating that given the opportunity to earn, the poor can save.

In both programs, critical pre-lending activities had to be undertaken before funds are disbursed. These are social preparation, formation of groups and associations, capability building, technical assistance for business management and productivity, capital assistance, and savings mobilization. This indicates that, per se, the poor, though they need funds, are not ready for credit. A good amount of resources must be invested to prepare them for credit.

Areas for Improvement

Cost per peso of the SEA-K loan was comparatively low at P0.10, but that of CECAP was high at P0.30 due to the salaries of the staff: 48

BDOs, five zone credit officers and two credit staff members at the project management office (PMO). Unlike in SEA-K where a social worker manages about 50 loans a year (representing the same number of groups, or 250 to 300 individuals), a BDO handles three or four groups or 60-80 individuals. BDOs only work part time with the credit program since they are also in charge of operating and monitoring other CECAP components such as health, community development, infrastructure, and technical assistance to agriculture.

Conclusions

Considering that the beneficiaries belong to the bottom 30 percent of the income ladder, the repayment rates of from 83 to 93 percent indicate good performance. This is attributed to the small loan sizes consistent with the borrowers' absorptive capacity, and to the strong social preparation component of the credit programs.

However, the social preparation component (involving such pre-lending activities as institution and capability building and various forms of training) represents unrecoverable costs for the government. Thus, while the SEA-K and the CECAP are effective in terms of outreach to target beneficiaries, they are not necessarily cost-efficient.

Moreover, since SEA-K loans are interest free, and those of CECAP at below market rates, the programs do not recover operations, administrative and other costs, making them insufficient and unsustainable, or dependent on budget donations and allocations.

RECOMMENDATIONS

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|---|--|
| <ol style="list-style-type: none"> 1. The basic principle is that government non-bank institutions should only act as catalyst of development. It cannot productively and efficiently handle bank-related functions like screening, loan disbursement and collection. 2. To insure credit worthiness of the poor, there must be appropriate mechanisms for screening, monitoring, and proper enforcement of program policies and procedures. 3. It must be made clear that credit is not welfare, and loans from government are not doleouts. Thus, measures must be pursued to make borrowers fully aware of their duties and responsibilities. At the same time, subsidies to the credit programs must be limited to a certain | <p>period, say three years. At some stage, the concept of interest rate must be introduced not only to allow recovery of administrative costs but also to prepare the participants in dealing with formal sources of credit.</p> <ol style="list-style-type: none"> 4. Taking off from the experiences of SEA-K and CECAP, other credit programs may be pursued, but with more focus on preparing the beneficiaries to the receipt of funds rather than on disbursing funds per se. 5. Since area-based or location-specific credit programs have good chances of success, credit programs must be designed to suit specific or particular conditions. |
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Based on a report prepared by Arelis Gomez-Alfonso and Jocelyn Alma R. Badiola, Consultants.

For further information, please contact

National Credit Council Secretariat Department of Finance

Undersecretary Ma. Cecilia G. Soriano, Ph.D
Ma. Teresa S. Habitan
Joselito Almario
Ma. Lourdes Dedal
Aurora Luz Villaviray
Febe Lim
Erick Tiggos
Nelia Lansang

*Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287*

Credit Policy Improvement Program Project Management Office

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo
Amor H. Colina

*7th Floor, EDPC Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph*



National Credit Council

Policy Notes

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Assessment of the Performance of GFIs and GOCCs/NBFIs in Implementing Directed Credit Programs

More than two decades have passed since the supply-led finance went out of vogue, yet directed subsidized lending programs proliferate to these days. In June 1997, the Credit Policy Improvement Program (CPIP) reported a total of 86 credit programs being managed by different departments/line agencies, government financial institutions (GFIs), government owned and controlled corporations (GOCCs) and non-bank financial institutions (NBFIs). These programs cater to specific sectors and are funded out of government budgetary allocation, special funds, official development assistance or other sources.

In view of the scarce resources of the government, it has become imperative to justify its expense items, including those that seek to provide social credit for the poor. Government programs, therefore, must achieve their objectives, and at the same time, recover costs if not generate income for their continued operations. The National Credit Council has been tasked to review credit programs to rationalize their existence.

A recent study (Lamberte 1997) attempted to assess the effectiveness and efficiency of some 37 directed credit programs (DCPs) implemented by

government non-financial agencies (GNFAs). While some of the programs were able to reach their target beneficiaries, the agencies, which run the programs, were not able to recoup their investments. The study, therefore, recommended that GNFAs focus on identifying and providing technical assistance to the sectors that need support and leave the implementation of DCPs to the banks.

Objectives of the Study

This study is a follow-up of the 1997 study on DCPs. It seeks to assess the performance of GFIs, GOCCs and NBFIs in administering these programs. More specifically, it aims to achieve the following:

- determine the effective cost (including administrative expenses and loan losses) to the implementing institutions;
- assess the relative effectiveness of the various modes employed; and
- examine the impact of the programs on the financial viability and operations of these institutions.

The study uses various indicators to measure the productivity, effectiveness and efficiency of 32 DCPs implemented by two GFIs and five GOCCs/NBFIs (**Annex A**). Productivity is measured in terms of the number and volume of loans granted as against

the number of personnel involved in the program. Effectiveness is measured in terms of outreach, meaning the program is able to reach the “basic sectors” consisting of small borrowers. Efficiency, on the other hand, is measured in terms of the recovery

Annex A

List of Directed Credit Programs Implemented by GFIs and GOCCs/NBFIs

NAME OF GFI/GOCC/NBFI	NAME OF DCP	ACRONYM
I. Government Financial Institutions (GFIs)		
a. Development Bank of the Philippines (DBP)	1. Asian Development Bank Third DBP Project	ADB III
	2. Cottage Enterprises Finance Project	CEFP
	3. US\$ 25 Million Tied Aid Credit Line from Danish Export Finance Corporation (DEFC) and Danish International Development Aid (DANIDA)	DBP Tie up Program from DEFC/DANIDA
	4. Damayan sa Pamumuhunan Program	DPP
	5. Domestic Shipping Modernization Program	DSMP
	6. Environmental Infrastructure Support Credit Program	EISCP
	7. US\$ 5 M Credit Facility for Agro-Prod. and Agro-Food Processing Projects from International Commercial Bank of China (ICBC)	ICBC Credit for Agro-Production and Food Processing Projects
	8. US\$ 10 Million Credit for Small and Medium Enterprises (SMEs) from International Commercial Bank of China (ICBC)	ICBC Credit for SMEs
	9. Industrial Guarantee and Loan Fund	IGLF
	10. Industrial Investment Credit Project	IICP
	11. Industrial Pollution Control Loan Project	IPCLP
	12. Industrial Re-structuring Program	IRP
	13. Industrial and Support Services Expansion Program	ISSEP
	14. EXIM Japan Untied Loan to DBP I	AJDF-JEXIM I
	15. EXIM Japan Untied Loan to DBP II	JEXIM II
	16. EXIM Japan Untied Loan to DBP III	JEXIM III
	17. US\$ 25 Million Mixed Credit Facility from Norway	MCF-Norway
	18. Overseas Economic Cooperative Fund	OECF
	19. Spanish Mixed Credit Facility	Spanish MCF
b. Land Bank of the Philippines (LBP)	20. 5-25-70 Financing Program	5-25-70 FP
	21. ADB Industrial Forest Plantation Project	IFPP
	22. ADB Small Farmers Credit Project	SFCP
	23. LBP-NPUDC Agricultural Livelihood Development Program for Rebel Returnees	ALDPRR
	24. Agricultural Loan Fund	ALF
	25. Rural Finance Project I (Countryside Loan Fund I)	CLF I
	26. Second Rural Finance Project (CLF II)	CLF II
	27. Kawal Pilipino Kabuhayan 2000	KPK 2000
	28. OECF-AJDF Small Farmers Credit Project	AJDF SFCP
	29. OECF Metro Cebu Development Project Phase III	MCDP III
	30. OECF Rural Farmers and Agrarian Reform Support Credit Program	RASCP
	31. Retail Co-financing Fund	RCF
	32. Special Livelihood Financing Assistance Program	SLFAP

NAME OF GFI/GOCC/NBFI	NAME OF DCP	ACRONYM
II. Government Owned and Controlled Corporations (GOCCs)/Non-Bank Financial Institutions (NBFIs)		
a. People's Credit and Finance Corporation (PCFC)	33. ADB-IFAD Rural Microenterprise Finance Project 34. Helping Individuals Reach Their Aspiration Through Microcredit Lending Program	ADB-IFAD RMFP HIRAM-LP
b. Quedan and Rural Credit Guarantee Corporation (QuedanCor)	35. Coordinated Agricultural Marketing/Production 36. Food and Agricultural Retail Enterprises 37. Farm Level Grains Center	CAMP FARE FLGC
c. Small Business Guarantee and Finance Corporation (SBGFC)	38. Rediscounting Facility for Small Enterprises 39. Small Enterprise Financing Facility	RDF-SE SEFF
d. Technology and Livelihood Resource Center (TLRC)	40. Agro-Industrial Technology Transfer Program 41. Alalay sa Hanapbuhay 42. Community Empowerment Program 43. Export Industry Modernization Program 44. Special Direct Micro Lending Program	AITTP ASAHAN CEP EIMP SDML
e. National Livelihood Support Fund (NLSF)	45. NLSF Livelihood Credit Assistance Program for Agrarian Reform Communities	LCAP for ARCs

of the total costs of the programs including administrative cost, risk-induced cost, cost of borrowed funds and cost of equity capital. Meanwhile, the impact on the institution's financial viability is examined in terms of income and expenses, loan exposures, return on assets and other basic indicators. Key officers of these institutions were also asked how the DCPs affected their operations.

A Look at the Implementing Institutions

Government financial institutions

The Development Bank of the Philippines (DBP) caters to agricultural and industrial small, medium and large enterprises (SMLEs). In 1996, it was permitted to operate as an expanded commercial bank, offering various products and services to its clients.

Following the recommendations of a study conducted under the World Bank Financial Sector Adjustment Loan in 1987, DBP's wholesale lending

increased substantially. By the first semester of 1998, the ratio of wholesale to retail accounts stood at 60:40. The wholesale lending is handled by the Wholesale Banking Group (WBG), and the retail lending services are administered through its three lending modes or windows depending on the maturity of loans.

The DBP currently administers 19 DCPs that are financed by foreign or domestic borrowings and special funds. Ten of these programs fall under the wholesale lending operations. They channel funds through private financial institutions as conduits. The remaining nine programs, which cater to SMLEs, are part of DBP's retail operations.

The Land Bank of the Philippines (LBP) serves as the financial arm of the Comprehensive Agrarian Reform Program. It is mandated to advance payments to landowners and collect amortization from farmer-beneficiaries. Following the granting of a new charter in 1995, LBP has had to balance its commercial

operations with its development mission through a unique combination of branches and field offices throughout the country. With the Unified Systems Project (USP), LBP was able to merge its field banking and agrarian operations, thereby ensuring a more efficient delivery of services.

There are 13 DCPs implemented by LBP, nine of which are funded by foreign loans while the rest are supported by local special funds.

Government Owned and Controlled Corporations and Non-Bank Financial Institutions

Among the GOCCs/NBFIs that implement DCPs are the National Livelihood Support Fund (NLSF), People's Credit Finance Corporation (PCFC), Quedan and Rural Credit Guarantee Corporation (Quedancor), Small Business Guarantee and Finance Corporation (SBGFC) and the Technology and Livelihood Resource Center (TLRC).

The NLSF administers the Livelihood Credit Assistance Program (LCAP) for agrarian reform communities. NLSF, which is supervised and administered by LBP, has a tall order of improving the quality of life of small farmers, fisherfolk and their dependents through institution building and credit delivery for livelihood projects. LCAP is jointly implemented by NLSF with the Department of Agrarian Reform to provide credit and support for wives and dependents of agrarian reform beneficiaries and others sectors under a special arrangement.

The PCFC was created to be the lead financial institution in the wholesale delivery of funds to nongovernment organizations (NGOs), people's organizations (POs) and rural banks (RBs) for relending to the poor or marginalized sectors of the economy. It is wholly capitalized by NLSF, which finances two credit programs – the Helping

Individuals Reach Their Aspirations through Microcredit (HIRAM) and the ADB-IFAD Rural Microenterprise Finance Project. Both programs provide loans for relending to the poor through financial institutions, NGOs and POs as conduits.

The Quedancor is mandated to establish credit support mechanism for farmers, fisherfolk, rural workers, cooperatives, retailers, wholesalers and agricultural producers and implement a guarantee system to promote inventory financing of agri-aqua commodities, establishing production and post-production facilities and acquisition of farm and fishery equipment. The Quedancor currently administers 13 DCPs, two of which are internally funded – the Coordinated Agricultural Marketing and Production (CAMP) and the Food and Agricultural Retail Enterprise (FARE) – and one, the Farm Level Grains Center (FLGC), is financed by the National Food Authority, also a GOCC. For the remaining 10 DCPs, Quedancor merely acts as fund administrator of government line agencies. CAMP and FLGC cater to agri-related activities while FARE assists the credit needs of market retailers. All three programs adopt the direct mode of credit delivery, with cooperatives, associations and individuals as borrowers.

The SBGFC was established to support the development of small and medium enterprises (SMEs) through the provision of credit and guarantee cover. At present, SBGFC implements a guarantee program and two lending programs, the Small Enterprise Financing Facility and the Rediscounting Facility for Small Enterprise.

The TLRC was created to hasten and enhance progress through research and development efforts and to harness indigenous and appropriate technologies. It currently administers five DCPs, two of which — the Agri-Industrial Technology Transfer Program (AITTP) and Export Industry Modernization Program (EIMP) -- are implemented by its Technology

Finance Assistance Group which is tasked to provide financial and technical assistance to improve the productivity and competitiveness of the production and export sectors. The three other programs — the Alalay sa Hanapbuhay, Community Empowerment Program (CEP) and Special Direct Microlending Program — are administered by its Livelihood Assistance Group which is responsible for providing funds for income-generating projects of SMEs.

Attributes of the DCPs

The DCPs implemented by GFIs and GOCCs cater to various sectors of the economy. **Table 1** shows that only seven DCPs (17%) service the agrarian and agriculture sectors and only five are meant for the poor. Majority of the programs (20 DCPs or 44%) do not distinguish their borrowers

(i.e., small, medium or large borrowers). GFIs, unlike GOCCs/NBFIs, do not target the poor as clients.

By type of assistance, 23 DCPs (51%) provide purely credit, 16 of which are accounted for by GFIs (**Table 2**). There are also 16 DCPs that provide credit with a component on institution building or social preparation. GOCCs/NBFIs, unlike GFIs, do not provide any program with technical assistance.

The DCPs covered by the study vary in their implementation period. Fifteen DCPS have been in operation for 5 to 10 years; another 15 are fairly young, i.e., they have only been around for one to two years (**Table 3**). Only GOCCs/NBFIs have programs running for more than 10 years.

Majority of the DCPs (67%) are financed by foreign loans or grants (**Table 4**). Eighteen percent are funded by special funds, and 15 percent by

Table 1
Distribution of DCPs by Target Sector

Target Sector	GFIs	GOCCs/NBFIs	ALL DCPs	(% of Total)
Agriculture/Agrarian	4	3	7	(16)
Small Livelihood Sector	5	2	7	(16)
SMLEs	14	3	20	(44)
Poor	—	5	5	(11)
Special Sectors ^{a/}	6	—	6	(13)
Total DCPs	32	13	45	(100)

^{a/} Includes environment, shipping, cornstarch, forest plantation and an LGU.

Table 2
Distribution of DCPs By Type of Assistance

Type of Assistance	GFIs	GOCCs/NBFIs	ALL DCPs	(% of Total)
Purely credit	16	7	23	(51)
Credit with IB/SP	7	4 ^{a/}	11	(24)
Credit with TA	8	—	8	(18)
Credit and Guarantee	1	2	3	(7)
Total	32	13	45	(100)

^{a/} Two programs with TA component also.

corporate or internal funds. GFIs, which account for the bulk of foreign-funded programs, do not have internally funded programs.

By mode of credit delivery, 19 DCPs (42%) provide loans directly to end-borrowers as against 26 DCPs (58%) that utilize conduits (**Table 5**). For the direct mode of credit delivery, 15 DCPs (33%) cater to individuals while three (7%) provide funds through groups. For the indirect mode of credit delivery, 15 DCPs (33%) use private financial institutions (PFIs) as conduits as against eight (18%) that use cooperatives, NGOs or POs to channel funds.

Meanwhile, 36 percent of the DCPs provide loans with long-term maturities (**Table 6**). Programs that offer mixed terms, ranging from short to long term also account for 36 percent of all DCPs. GFIs implement the majority of DCPs that fall under these

two categories. Most of the programs of GOCCs/NBFIs (10 out of 13 DCPs), on the other hand, account for programs offering short- to medium-term maturities.

On lending rates, GFIs generally charge higher interest rates, equivalent to WAIR (91-day T-bill rate) on loans of PFIs serving as conduits, compared to 12 to 16 percent per annum charged on loans of cooperatives, NGOs, POs and local government units (**Table 7**). Conduits usually charge the same pass-on rate which is equal to WAIR plus spread. Interest charges range from a low five percent to as high as the pass-on rate of PFIs. The rate largely depends on the source of funds and the policies promoted by the program. GOCCs/NBFIs charge interest rates of about 14 to 30 percent on loans to cooperatives, NGOs and POs. Those on loans to end-borrowers under the direct lending mode range from 14 percent to WAIR.

Table 3
Distribution of DCPs by Number of Years in Operation

Years in Operation	GFIs	GOCCs/NBFIs	ALL DCPs (% of Total)
1-2 years	8	7	15	(33)
3-4 years	9	3	12	(28)
5-10 years	15	—	15	(33)
more than 10 years	—	3	3	(6)
Total	32	13	45	(100)

Table 4
Distribution of DCPs by Source of Fund

Source of Fund	GFIs	GOCCs/NBFIs	ALL DCPs	(% of Total)
Foreign Loan or Grant	27	3	30	(67)
Special Funds ^{a/}	5 ^{b/}	3 ^{c/}	8	(18)
Corporate/Internal Funds	—	7	7	(15)
Total	32	13	45	(100)

^{a/} Include CDF and funds from other GOCCs

^{b/} Two programs (DBP's DPP and LBP's 5-25-70) are supplemented by the bank's internal funds

^{c/} One program (TLRC's ASAHAN) is supplemented by corporate funds

Table 5
Distribution of DCPs by Mode of Credit Delivery

Mode	GFI	GOCCs/NBFIs	ALL DCPs	(% of Total)
Direct Mode	13	6	19	(42)
Group a/	2	1	3	(7)
Individuals b/	11	4	15	(33)
Both	—	1	1	(2)
Indirect Mode	19	7	26	(58)
PFI	13	2	15	(33)
Coops/NGOs/POs	6	2	8	(18)
Both	—	3	3	(7)
Total	32	13	45	(100)

a/ Strictly cooperatives only.

b/ Includes single proprietorships, partnerships or corporations;
also includes LGU under MCDPIII

Table 6
Distribution of DCPs by Maturity of Loans Granted

Maturity of Loans	GFI	GOCCs/NBFIs	ALL DCPs	(% of Total)
Short term (1 to 18 months)	—	6 ^{a/}	6	(13)
Medium term (19 mos to 5 years)	3	4	7	(15)
Long term (above 5 years)	14	2	16	(36)
Mixed terms (short to long term)	15	1	16	(36)
Total	32	13	45	(100)

a/ Three programs (RMFP, HIRAM and LCAP) have soft loans with maturity of 3-5 years

Results of the Assessment

Productivity of DCPs

Assessment of the performance of DCPs shows that productivity is significantly higher for those administered by GFIs than those run by GOCCs/NBFIs. The average productivity indices in terms of the number and volume of loans granted are 45.01 and 11.68, respectively for GFIs and 18.45 and 7.70, respectively for GOCCs/NBFIs (**Table 8**). The same

is true for the productivity indices in terms of the number and volume of loans outstanding which are 28.76 and 15.69, respectively for GFIs and 11.12 and 6.95, respectively for GOCCs/NBFIs. The average number of personnel of GFIs is 5.0 compared to 20.0 for GOCCs/NBFIs, implying a higher staff efficiency for the former and a higher administrative cost for the latter.

The management, size and maturities of loans, as well as the mode of credit delivery, affect

Table 7
Range of Interest Rates Charged
by GFIs and GOCCs/NBFIs
By Mode of Credit Delivery, Per Annum

	Direct to Individuals/Groups	Indirect thru	
		PFI	Coops/POs/NGOs/ LGUs
GFIs			
To conduits	—	WAIR (91 day T-bill)	12% to 16%
To end-users	5% to WAIR (91 day T-bill) + 2-2.5% ^{a/}	WAIR (91 day T-bill) + PFI spread	market rate ^{b/}
GOCCs/NBFIs			
To conduits	—	WAIR (91 day T-bill)	12% ^{c/}
To end-users	14% to WAIR (91 day T-bill)	Market rate ^{b/}	14% -30%

^{a/} CDF funds are interest-free; rate charged on LGU under MCDP III is 4.3-4.7%.

^{b/} Unprescribed rate which may also equal to WAIR (91 day T-bill rate) + spread of conduit.

^{c/} For institutional loans, interest rate is 3%.

Table 8
Average Productivity of GFIs, GOCCs/NBFIs
and GNFA in Implementing DCPs,
By Mode of Credit Delivery, 1994-97

	Ave. No. of Personnel	Loans Granted/ Personnel		Loans Outstanding/Personnel		
		Number	Amount (PM)	Number	Amount (PM)	Net of Past Due (PM)
A. GFI						
Direct Mode	3.67	45.67	2.36	21.5	13.00	11.79
Indirect Mode	6.34	44.35	20.99	31.18	16.58	16.26
Average	5.00	45.01	11.68	28.76	15.69	15.14
B. GOCC/NBFI						
Direct Mode	25.25	31.75	4.08	18.97	4.93	4.76
Indirect Mode	15.50	5.15	11.33	5.22	8.97	8.93
Average	20.38	18.45	7.70	11.12	6.95	6.85
C. GNFA a/						
Direct Mode	14.98	15.5	1.99	14.57	4.65	3.85
Indirect Mode	20.11	37.8	4.69	8.82	15.78	9.53
Average	18.46	30.4	3.82	11.06	12.48	7.85

^{a/} From Lamberte et al. (1997).

productivity. In general, DCPs that are productive are those that have full-time personnel, short-term maturities, big loan portfolios, and employ the indirect mode of credit delivery.

Reaching the target borrowers

To ascertain the outreach of DCPs or overall outreach index, the ratio of the average loan size of the target sector to the average loan size of the program (reaching-the-target borrowers index or RTBI), as well as the ratio of actual borrowers to the potential borrowers (credit extension index or CEI), were computed.

Table 9 suggests that the average loan size varies widely depending on the kind of project, type of conduit, and number of end-borrowers. RTBIs show that GFIs (1.06) are generally effective in reaching borrowers than do GOCCs/NBFIs (.60). The figures also show that DCPs employing conduits (e.g., LBP's RASCP, KPK 2000, NLSF's LCAP, and PCMC's RMFP) have higher RTBIs.

The overall outreach index (weighted average of the RTBI and CGI) show that DCPs administered by GFIs reach their potential borrowers more than those run by GOCCs/NBFIs, except for PCFC's HIRAM.

Efficiency of DCPs

How efficient are the implementing institutions in administering the DCPs?

The cost recovery index (CRI or the ratio of income from lending to the total cost of lending) was used to measure efficiency. A DCP is considered efficient if at least one of the measures of CRI is equal to or greater than one. For this study, four CRIs were computed for each DCP using the following:

For CRI₁, nominal effective interest rate as

revenue from loan and inflation rate-based and cost of equity capital;

CRI₂, nominal effective interest rate as revenue from loan and T-bill rate-based cost of equity capital;

CRI₃, contracted or posted interest rate as revenue from loan and inflation rate-based cost of equity capital; and,

CRI₄, contracted or posted interest rate as revenue from loan and T-bill rate-based cost of equity capital.

Calculations show that 19 of the 32 DCPs are efficient, 16 of which are administered by GFIs. These programs are able to generate sufficient income from lending to cover their costs. Three of the efficient DCPs for small farmers are run by GFIs. Of the eight inefficient DCPs for the small borrowing sector, five are accounted for by GOCCs/NBFIs, and three by GFIs. Of the 18 DCPs for SML borrowers, only five are inefficient. All of the 11 DCPs for SML borrowers using the indirect mode of credit delivery are efficient. Moreover, for small borrowers, inefficient DCPs cater to significantly large numbers of borrowers than efficient DCPs. They also have much larger average loan sizes, unlike their counterparts for SML borrowers. Inefficient DCPs for SML borrowers have larger average loan maturity than their efficient counterparts.

Table 10 shows that GFIs incurred lower administrative cost (5 centavos for every peso lent out), than GOCCs/NBFIs (36 centavos). Lending directly to end-borrowers seems to be more expensive than lending through conduits.

Impact of DCPs on the Implementing Institutions

Key informants were asked about their perceptions on the DCPs in terms of their impact on loan portfolio, income, revenue and expenses.

Table 9
Reaching the Target Borrowers Indices For the Period 1994-97

Name of Program	Average Loan Size (in pesos)	Ave. Size of Loan in Sector (in pesos)	RTB Index a/
A GFIs			
Direct			0.04
DBP - DPP	541,423.00	24,834.00	0.05
LBP ñ 5-25-70*	1,040,330.00	33,730.00	0.03
LBP ñ SLFAP*	196,000.00	8,930.00	0.05
Indirect			2.07
DBP - CEF	107,273.00	24,834.00	0.23
LBP ñ RASCP**	4,866.00	19,840.00	4.08
LBP - KPK 2000***	4,710.00	9,020.00	1.90
Average GFIs			1.06
B. GOCCs/NBFIs			
Direct			0.30
QUEDANCOR - FLGC I*	227,120.00	18,854.00	0.08
QUEDANCOR - FARE	64,590.00	8,620.00	0.13
QUEDANCOR - CAMP	787,950.00	32,230.00	0.04
TLRC - SDML****	29,456.98	27,974.08	0.95
Indirect			0.89
NLSF - LCAP for ARCS**	7,038.83	7,520.00	1.07
PCFC - HIRAM****	9,650.00	7,340.00	0.76
PCFC - ADB-IFAD RMFP**	5,650.00	7,520.00	1.33
TLRC - CEP****	17,993.74	7,340.00	0.41
Average - GOCCs/NBFIs			0.60

a/ Average sector loan/Average loan size

* covers the period 1995-1997.

** covers 1997 only.

*** covers 1996 only

**** covers the period 1996-1997.

Effect on Policies. Lending policies and procedures applied under the DCPs do not differ significantly from those imposed under regular credit facilities, except for those funded by foreign donors whose operating guidelines may be slightly different in terms of coverage, criteria, interest rate and maturity.

Effect on Loan Portfolio. Many of the DCPs have increased the loan portfolio of implementing institutions. However, they have also increased the total loans outstanding. For DBP, outstanding loans have expanded at a faster rate than the bank's aggregate loan portfolio (Table 11).

Effect on Viability. Implementing the DCPs has

also been profitable to the GFIs, as well as to GOCCs/NBFIs albeit minimally. LBP and DBP, for instance, derive at least two percent and 12 percent, respectively, of their income from the DCP operation.

However, the most significant effect cited by the key informants is the fulfillment of the institution's mandated function. Through the DCPs, DBP is able to contribute to environment awareness, socioeconomic growth and overall national development.

Table 10
Average Administrative Cost of Efficient (and Inefficient) DCPs for Small Borrowers
by Type of Institution and by Mode of Credit Delivery*

	Mode of Credit Delivery					
	Direct		Indirect		Both Modes	
	No. of DCPs	Average Administrative Cost (%)	No. of DCPs	Average Administrative Cost (%)	No. of DCPs	Average Administrative Cost (%)
A. GFIs						
Efficient DCPs	1	6.64	2	1.19	3	3.00
Inefficient DCPs	2	8.42	1	5.03	3	7.29
All DCPs	3	7.83	3	2.47	6	5.15
B. GOCCs/NBFIs						
Efficient DCPs	2	2.22	1	3.04	3	2.49
Inefficient DCPs	2	105.57	3	21.73	5	56.47
All DCPs	4	55.40	4	17.06	8	36.23
C. GNFA*						
Efficient DCPs	0	—	0	—	0	—
Inefficient DCPs	10	50.08	22	17.69	32	27.81
All DCPs	10	50.08	22	17.69	32	27.81

* See annex E for the estimates of administrative cost of each DCP.

** From the results of the CPIP study entitled "Assessment of the Role and Performance of GNFA in Implementing DCPs".

Table 11
Percent Share of Outstanding Loans of DCPs to Total Loans Outstanding
of GFIs and GOCCs/NBFIs

	No. of DCPs	1994	1995	1996	1997	Average	Average Growth Rate, %
DBP							
Total Loans Outstanding (PM)		39732.7	42323.9	46759.4	64087.3	48225.8	18.02
% DCPs	12	47.94	54.66	85.08	50.13	59.45	24.72 *
LBP							
Total Loans Outstanding (PM)		36353.6	60226.7	82856.2	98498.8	69483.8	40.71
% DCPs	9	9.81	7.27	6.47	7.98	7.9	30.62 *
NLSF							
Total Loans Outstanding (PM) ^{a/}				1114.7	1059.9	1087.3	-4.92
% DCPs	1				3.08	3.1	
PCFC							
Total Loans Outstanding (PM)				135.9	236.6	186.3	74.10
% DCPs	2			100.00	100.00	100.00	74.10 *
QUEDANCOR							
Total Loans Outstanding (PM)		297.0	423.6	492.6	496.9	427.5	19.92
% DCPs	3	87.19	72.07	56.48	73.56	72.33	13.46 *
SBGFC							
Total Loans Outstanding (PM) ^{b/}		8.66	180.37	303.44	695.7	297.0	726.77
% DCPs	2	77.37	96.47	7.75	96.22	92.0	897.72 *
TLRC							
Total Loans Outstanding		—	—	—	—	—	—
Loans Outstanding of DCPs (PM)	3	319.1	287.1	284.31	302.4	298.2	-1.55

^{a/} Comprised of loan receivables from PCFC and KKK/BKKK.

^{b/} Includes notes receivables with guarantee called.

^{c/} Comprised of 1 DCP in 1994 to 1995 and 3 DCPs starting 1996.

* Average growth rate of DCP outstanding loans.

RECOMMENDATIONS

The preceding data show that the DCPs managed by GFIs have performed better in terms of being able to reach their target borrowers and recover costs than those managed by GOCCs/NBFIs. The following measures are recommended:

- **Transfer the management of DCPs from GOCCs/NBFIs to GFIs.** The DBP and LBP must continue to implement the DCPs and absorb those run by GOCCs/NBFIs. GFIs have clear accountability, and they are directly supervised by the Bangko Sentral ng Pilipinas. DBP could focus on SMEs and industry projects while LBP could serve as the main financial institution to cater to agriculture and agrarian reform. NLSF's LCAP, SBGFC's RDF and SEFF and TLRC's AITTP and SDML may be transferred to DBP. Meanwhile, the PCFC's lending functions, the various lending programs of Quedancor and TLRC's CEP may be assumed by LBP.
- **Subsume duplicating programs of GOCCs/NBFIs with those of the GFIs.** GFIs can maximize economies of scale while saving resources for the government.
- **Adopt the indirect mode of credit delivery.** The use of conduits, especially those that have closer relationship with end-borrowers, will enable GFIs

to leverage its limited funds for onlending to target beneficiaries and, at the same time, avoid competition with the private sector. DBP, for instance, could improve operations by transferring the programs under the Window III of its retail operations to the bank's WBG.

- **Refocus mandate of GOCCs/NBFIs.** With the transfer of DCPs to GFIs, the GOCCs/NBFIs can direct their attention to their main function. Quedancor, for instance, can focus on the provision of loan guarantee and warehouse bonding. TLRC could concentrate on the development and promotion of technologies to improve target sectors. Meanwhile, SBGFC's mandate could be refocused, and PCFC was recommended to be abolished.
- **Create a joint committee for DCPs.** DBP and LBP should create a joint committee to improve the effectiveness in implementing DCPs and to avoid overlapping of programs. The committee will formulate policies, design mechanisms to monitor performance of DCPs and provide a forum for the public discussion of issues related to DCPs.

Based on a report prepared by Thomas M. Fitzgerald, Feliciano L. Miranda, Jr., David S. Murphy and Gerald S. Schulz, Consultants.

For further information, please contact

National Credit Council Secretariat Department of Finance

Assistant Secretary Gil B. Beltran
Ma. Teresa S. Habitan
Joselito Almario
Ma. Lourdes Dedal
Aurora Luz Villaviray
Febe Lim
Erick Tiggos
Nelia Lansang

4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287

Credit Policy Improvement Program Project Management Office

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo

4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph



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Microlending After the Asian Financial Crisis

The vulnerability of the banking system to foreign capital movements has been put to test with the onslaught of the Asian financial crisis in mid-1997. These days many are questioning the wisdom of unregulated capital flows, especially as they affect the welfare of the people.

The effects of the recent financial crisis on the economic well-being of the poor may be viewed by examining the volatility of deposits and the loan portfolio of rural banks, credit unions/cooperatives and non-governmental organizations (NGOs) engaged in microlending. As the primary lenders in the rural areas, any adverse impact on these institutions would also affect the plight some of the most vulnerable sectors of society.

To carry out this inquiry, data in the past three years from 16 institutions (9 rural banks, 6 cooperatives and an NGO) were analyzed and assessed using two hypotheses.

First, the squeeze in foreign currency resulted in a significant conversion of peso deposits to dollar deposits, a cutthroat competition for deposits due to high interest rates, or a flight of deposits to safety. All of these indicate a movement of peso deposits

from small rural financial institutions to commercial banks.

Second, the loan portfolios of rural financial institutions were adversely affected due to loan recovery problems, an overall slowdown in local economy, or some other liquidity problems associated with the peso devaluation.

Rural Banks

Rural banks have been traditionally more involved in microlending than other banks. Given the fact that they do not have foreign-currency denominated loans and that they thrive in locally-based economies, could they have been affected by the Asian financial crisis?

Growing Resources

From September 1996 to September 1997, total resources of rural banks increased by 27.2 percent, compared to a year-ago growth of 30 percent. (Table I) The trend approximates that of the entire banking system, wherein assets rose by 33.5 percent in the same period from a year-ago growth of 35.8 percent.

Table I
Comparative Selected Accounts of Rural Banks

In Million Pesos

ACCOUNTS	Dec. 31, 1995		Dec. 31, 1996			Sep. 30, 1997		
	Amount	% to Total Assets	Amount	% to Total Assets	% Increase over 1995	Amount	% to Total Assets	% Increase over 1995
Total Assets	32,974	100.0	42,825	100.0	30.0	54,467	100.0	27.2
Cash and due from banks	6,423	19.5	7,465	17.4	16.2	8,803	16.2	17.9
Loans	22,283	67.6	29,661	69.3	33.1	38,623	70.9	30.2
Deposits	21,214	64.4	27,443	64.1	29.3	34,981	64.2	27.5
Capital Accounts	5,359	16.3	6,629	15.5	23.7	8,347	15.3	25.9
Loans to Deposit Ratio		105%			108.1%			110.4%
Cash and due from banks to deposits ratio		30.3%			27.2%			25.2%
% of total assets of RBs to total assets of the banking system		2.3%			2.2%			2.1%
% of deposits of RBs to total deposits of the banking system		2.1%			2.3%			2.2%

Source: BSP

The increase in total assets of the rural banks was accounted for largely by an expansion in deposit and capital. Deposits expanded by 27.5 percent during the first nine months of 1997, representing 2.21 percent of total deposits of the entire banking system.

Deposit trends among sample banks

All of the nine sample banks posted substantial growth in total deposits in 1997. The Producers Rural Bank of San Jose City, for instance, generated P73.3 million deposits in 1997, up from P20.5 million in 1996. Even the remote Rural Bank of

Barili (Cebu) registered some P69.4 million deposits in 1997, up from 29.5 million in 1995. Total assets of the nine sample banks grew at an average rate of 20 percent over the past three years. Some rural bankers have been quick to attribute the increase in deposit to the personal relationships they have developed with their clients.

There was no perceived pattern in the distribution of deposit by type of accounts. Generally, a time deposit account was more preferred than a savings account because of higher returns. This is true for the Rural Bank of San Leonardo (Nueva Ecija), the Cooperative Rural

Bank of Cebu, and the Rural Bank of Itogon (Benguet). In other banks, particularly those in remote areas, such as the Rural Bank of Sto. Tomas (Davao del Norte), Highland Rural Bank (Benguet), Rural Bank of La Trinidad and Rural Bank of Barili, depositors were more interested in liquidity, and hence, deposits were placed in savings accounts.

Physical expansion

The growth in the assets of rural banks was accompanied by substantial growth in the number of banking offices. As of 30 September 1997, there were 824 head offices and 826 branches of rural banks, representing 92.7 percent and 13.9 percent of the total banking system respectively. In 1995, there were only 798 rural bank head offices and 658 branches. (Table 2)

Table 2
Comparative Selected Accounts
of the Banking System

In Million Pesos

ACCOUNTS	Dec. 31, 1995		Dec. 31, 1996			Sep. 30, 1997		
	Amount	% to Total Assets	Amount	% to Total Assets	% Increase over 1995	Amount	% to Total Assets	% Increase over 1995
Total Assets	1,447,968	100.0	1,975,046	100.0	36.1	2,636,482	100.0	33.8
Cash on Hand and in Banks	186,005	12.8	218,214	11.1	17.1	283,479	10.8	30.1
Loans	868,685	60.0	1,237,354	62.8	42.4	1,658,382	62.9	34.1
Investments	239,539	16.5	311,753	15.8	30.1	396,495	15.0	27.3
Deposits	901,226	62.2	1,187,270	60.1	31.4	1,577,890	59.8	33.2
Bills Payable	178,732	12.4	273,855	13.9	53.2	369,772	14.0	35.0
Capital Accounts	192,900	13.3	247,175	12.5	28.1	318,598	12.1	28.9
Loans to Deposit Ratio		96.4%			104.4%			105.1%
Cash on Hand and in Banks to deposits ratio		20.6%			18.4%			18.0%

Source: BSP

Contraction in liquidity

Selected data on the assets, liabilities and capital accounts of rural banks indicate some contraction in liquidity. Cash and due from banks as a percentage of total assets declined from 17.4 percent in 1996 to 16.2 percent in 1997, while the liquid assets-to-deposit ratio dropped from 27.2 percent to 25.2 percent. (Table 1)

Meanwhile, the percentage of loans-to-total assets rose from 69.3 percent to 70.9 percent during the same period, while the loans-to-deposit ratio went up from 108.1 percent to 110.4 percent.

Table 3
Profitability of Rural Banks

Quarter Ending	6/30/95	6/30/96	6/30/97	9/30/97
Interest Income/Interest Expense	209	199	191	187
Net Income/Total Assets	.80%	.80%	.75%	.66%
Net Income/Total Cap. Accounts	4.80%	5.16%	5.07%	4.31%
Overhead (expenses other than Interest) to total income	43.80%	42.50%	41.70%	43.50%

Source: BSP

Effects on profitability

Statistics on the profitability of rural banks suggest a modest effect. Returns on total assets declined from 0.75 percent during the second quarter of 1997 to 0.66 percent in the following quarter. The same trend is manifested for the return on equity, which decreased from 5.07 percent to 4.31 percent during the same period. (Table 3)

Reduced profitability may be attributed to several factors: intensified competition, high cost of funds and low repayment. Between 1996 and 1997, past due loans of the nine sample banks increased by 55.2 percent, while provisions for bad debts charged against current operations increased by 286.9 percent.

Quality of loan portfolio

Statistics from the Bangko Sentral ng Pilipinas (BSP) indicate that rural banks have had much higher levels of non-performing loans in recent years than either commercial banks or thrift banks (Table 4). Double-digit non-performing loan percentages (NPL/total loans), as in the case of rural banks, usually indicate significant loan problems. However, all the bankers who were interviewed believed that their portfolio problems are

“manageable.” Some encountered “moderate” problems; others reported that income derived from lending has been offset by a high cost of funds; and still others were “successful” in collecting scheduled payments.

The high levels of non-performing loans among rural banks could, therefore, be caused by a few banks that had significant loan problems, so much so that they skewed the aggregate figures when the reports are taken together.

But barring this fact, it was observed that a great deal of discretion was used in reporting past due loans. This has led to inconsistency of information among institutions as well as within these institutions.

Credit unions/cooperatives

Credit unions/cooperatives have thrived in areas where they have bridged the gap in the demand for microlending that was traditionally underserved by banks. They have evolved to take on a more holistic role by promoting thrift among members, generating funds for loans and providing related service to maximize benefits from such loans.

Table 4
Non-Performing Loans (NPL), Total Loans
and Loan Loss Provisions of the
Banking System

end-of-period
levels in billion pesos, ratios in percent

	Performing Loans								Total Loans			
	KBs/I	KBs' NPL/Total	TBs	TBs' NPL/Total	RBs	RBs' NPL/Total	Total	Total NPL/Total	KBs/I	TBs	RBs	Total
	KB loans		TB loans		RB loans							
1995	28.008	3.233	7.038	7.894	3.997	16.06834171	39.043	3.983	866.330	89.156	24.875	980.361
1996	34.203	2.799	9.452	7.741	4.723	14.13944855	48.378	3.513	1221.762	122.108	33.403	1377.273
Mar-97	42.319	3.294	9.856	7.434	5.099	14.85765902	57.274	3.946	1284.591	132.580	34.319	1451.490
Jun-97	47.857	3.373	11.289	7.742	5.399	14.63341916	64.545	4.030	1418.953	145.814	36.895	1601.662
Sep-97	59.584	3.975	14.934	10.092	5.399a/	14.63341916	79.917	4.746	1498.941	147.985	36.895a/	1683.821
	Loan Loss Provisions				Ratios							
	KBs/I	TBs	RBs	Total	Total Loan Loss Provisions/ Total Loans (%)	Total NPL/Total Loans (%)						
1995	13.781	2.376	0.686	16.843	1.718	3.983						
1996	15.149	3.279	0.680	19.108	1.387	3.513						
Mar-97	16.939	3.011	0.694	20.644	1.422	3.946						
Jun-97	18.517	3.071	0.716	22.304	1.393	4.030						
Sep-97	21.517	3.206	0.716a/	25.439	1.511	4.746						

I/ Inclusive of specialized government banks.

a/ As of end-June 1997

Source: Selected Philippine Economic Indicators, (BSP, February 1998)

In 1995, 3,955 out of the 25,460 operating cooperatives reported to the Cooperative Development Authority (CDA). Some 182,153 members out of total members of 722,035 belong to 416 credit unions. Table 5 shows the total assets, liabilities, equity reserves and net income of these cooperatives.

Growth patterns among sample coops

The resources of the six sample cooperatives grew by 28.5 percent between 1996 and 1997, accounted for mainly by increases in deposit (21.9%) and in equity (28.4%). Income in 1997 increased by 35.5 percent relative to that of 1996, thereby improving return on equity.

The sample cooperatives varied in the volume of their deposit base. Some enjoyed strong deposit base like the Baguio-Benguet Community Credit Cooperative (with nearly 150 million deposits in 1997) and the Cebu People's Multi-Purpose Cooperative (with P20 million deposits in 1997, up by 20% from the level in the previous year). Others had limited deposit base such as the Tikay Credit Cooperative (Bulacan) and the Barili Multi-Purpose Cooperative.

Adverse impact on loan portfolio

Based on interviews with sample cooperatives, the financial crisis had varying effects on the loan portfolio of credit unions/cooperatives. Some

Table 5
Profile of Cooperatives 1995

Amounts in millions

	All Cooperatives	Credit Cooperatives
Total Assets	P8,509.50	P2,235.90
Total Liabilities	P4,610.30	P785.10
Total Equity Res.	P3,899.20	P1,450.80
Net Income	P555.70	P149.60
Return On Asset	6.5%	6.7%
Return On Equity Res.	14.2%	0.3%

Source: Cooperative Development Authority

reported high delinquencies while others indicated they were doing well. There were cases of default in loan payments as a result of a diminution in income of some members who experienced reduced working hours or loss of job altogether.

Moreover, the drought that struck the country in the second half of 1997 destroyed crops and affected the paying capacity of borrowers. Debt servicing problems on agricultural loans was also attributed to hampered access to markets for produce, high prices of inputs and low prices of produce.

By and large, it is difficult to quantify the problems of credit unions/cooperatives because of the lack of timely, accurate and comprehensive information on the thrift activities of cooperatives. The CDA is not authorized to examine or audit the books of accounts and records of cooperatives. But suffice it to say that credit and liquidity problems exist.

Difficulty in assessing NGOs

It is even more difficult to assess the performance of NGOs in the light of the financial crisis. They are neither regulated nor do they adopt uniform accounting procedures.

NGOs are not allowed to accept deposits from the public, however, some NGOs have savings deposits either in the form of voluntary savings or in compensating balances, or what is referred to as "forced savings."

The asset quality of NGOs could not be ascertained as well because credible information is not readily available.

Liquidity is crucial

Some rural financial institutions have been experiencing liquidity problems largely due to seasonal factors affecting production, inability/unwillingness of borrowers to repay loans, drawbacks in pursuing secondary sources of funds, and lack of understanding the importance of liquidity management.

Liquidity is important for an institution to gain public confidence. The slow repayment of loans may be a manifestation of the lack of confidence in an institution's ability to fund new loans. Interestingly, institutions that complained of not having sufficient deposits and of high cost of borrowing for relending, are the same institutions that reported slow repayment. In such instances, borrowers would rather keep the money and just pay interest on it.

The effects of the financial crisis that recently hit Asian economies had been modest. While some financial institutions encountered liquidity problems, they hardly had any significant dent on the banking system for their assets constituted less than one percent of the total assets of banks. Loan problems seemed to be seasonal and geographic in nature, and some lenders believed that they were “manageable.”

Rural banks recorded substantial growth in assets and number of offices and branches. There was also no significant diversion of deposits from rural banks to other types of banks. However, the declining liquidity and profitability of these banks deserve some attention.

Other problems that also confronted credit unions/cooperatives and NGOs can be summed up as follows: (1) reduction of borrowing capacity due to high interest rates; (2) loan delinquencies resulting from reduced income of borrowers and unwillingness to repay existing loans due to fear of not being able to get new loans when needed; (3) insufficient funds to meet loan demand; and (4) liquidity problems.

The BSP was quick to respond to the deteriorating quality of assets among banks by issuing circulars prescribing higher minimum capitalization, larger provision for debts, earlier recognition of problematic accounts and a cap on real estate loans.

However, there is much to be desired in being able to monitor and regulate credit unions/cooperatives and NGOs. If these institutions are supervised and regulated, the management of liquidity, which is at the root of many problems, would be properly addressed. Good management of liquidity would likewise strengthen public confidence in these institutions, thus helping ensure

patronage and sustainability.

The ability to monitor and regulate rural financial institutions would help address the basic problem of lack of timely, accurate financial information. Even the assessment of rural banks, which are supposed to be closely supervised and regulated by the government, has been wanting due to lack of good financial information.

The foregoing conclusions point to the following recommendations:

- Address lack of timely and accurate financial information by instituting a good financial information system that could be audited/inspected periodically. Incentives and/or penalties could be considered to achieve desired results.
- Strictly enforce BSP Circular 143 to eliminate inconsistencies in reporting past due loans. Further study may be needed to determine the adequacy and responsiveness of existing loan portfolio indicators.
- Amend the Cooperative Code (RA 693) to effectively monitor, regulate and supervise the operations of credit unions/cooperatives to enhance their stability and to improve public confidence.
- Address the deposit-taking activities of NGOs to safeguard the stake of members. Further study should be done to determine the extent of these activities and their impact in local economy and the overall financial market.
- Help improve loan repayment by fully understanding the correlation between slow repayment and availability of funds to lend. Greater credit discipline will improve portfolio quality and liquidity.
- Continue serving the demand for microfinance by an honest-to-goodness acceptance that the rural poor could be creditworthy and that microlending could be viable and profitable.

For further information, please contact

**National Credit Council Secretariat
Department of Finance**

Assistant Secretary Gil B. Beltran
Ma. Teresa S. Habitan
Joselito Almario
Ma. Lourdes Dedal
Aurora Luz Villaviray
Febe Lim
Erick Tiggos
Nelia Lansang

*4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287*

**Credit Policy Improvement Program
Project Management Office**

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo

*4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph*



National Credit Council

Policy Notes

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Loan Guarantee Programs in the Philippines: *The Dilemma of Sustainability and Outreach*

Loan guarantee schemes seek to augment and direct lending to selected target groups and activities. These schemes are implemented on the following assumptions:

- Financial markets exclude from borrowing many individuals who could efficiently employ additional funds;
- Lenders are unwilling to provide loans to these groups because of perceived loan-recovery risks due to deficient loan collateral; and
- Desired lending can be stimulated by transferring to a third party a portion of the recovery risk associated with new borrowers by providing collateral substitutes in the form of external loan guarantees.

Loan guarantee schemes continue to exist in many developing countries. Although economic and financial reforms effected in these countries have lessened the emphasis on directed and subsidized lending, advocates still argue that such schemes achieve some objectives of directed credit policy at less cost and less adverse effects. Typically, loan guarantee schemes in these countries are either

government-owned or government- or donor-funded. They also require subsidies to persist.

A Policy Tool that Needs Reforms

In the Philippines, loan guarantee schemes are still widely employed as a policy tool. As of mid-1998, there are eight government-sponsored loan guarantee programs in the country. Two concentrate on loans for small- and medium-sized businesses ñ the Guarantee Fund for Small and Medium Scale Enterprises (GFSME) and the Small Business Guarantee and Finance Corporation (SBGFC). Three focus on agricultural and fishery loan programs ñ the Quedan and Rural Credit Guarantee Corporation (Quedancor), the CARP-Credit Guarantee Fund for Agricultural Landowners, and the Fisheries Sector Program of the Philippine Crop Insurance Corporation (PCIC-FSP). There is also a housing-loan guarantee program ñ the Home Insurance Guarantee Corporation (HIGC). Two programs are for export and industrial loans ñ the Philippine Export and Foreign Loan Guarantee

Corporation (Philguarantee) and the Industrial Guarantee and Loan Fund (IGLF).

In 1994, the Department of Finance sought to consolidate some of the existing loan guarantee programs to reduce duplication of efforts, streamline the bureaucracy and lower the overall costs of these activities. Such recommendations were supported by a 1993 study of 10 government-sponsored loan guarantee programs. The study found that government contribution in these programs have been substantial (around P5.6 billion in capitalization and 933 employees) and that the average annual return on the capital invested in these funds (including guarantee fees and investment income) was less than three percent. The recommendation to reduce the number of loan guarantee programs to six, however, was not implemented.

More Studies

There have been more research done on loan guarantee programs in the Philippines than in any other developing country. In the past decade, evaluation studies focusing on small-scale borrowers have been conducted by the Agricultural Credit Policy Council (1990), the Philippine Institute for Development Studies (1993) and the Credit Policy Improvement Program (1997). Within the same period, two foreign analysts ñ Gudger (1984) and Siebel (1995) ñ made additional brief assessments of loan guarantee schemes in the country.

Despite the negative results of the three evaluation studies, as well as similar conclusions by the foreign analysts, policymakers have not reformed these loan guarantee programs.

Criticisms of the studies have been expressed, particularly on the 1997 CPIP study. Administrators of the programs covered by the CPIP study argued that guaranteed loans were going to borrowers who

would otherwise not obtain formal loans, and that the large guaranteed loans made by the marketing intermediaries indirectly benefited numerous poor people who have been receiving subsequent loans. The administrators also claimed that changes in loan guarantee procedures since 1990 substantially enhanced the performance of their programs.

Objectives and Methodology

This study aims to assess the performance of three loan guarantee programs in the Philippines, namely: the Guarantee Fund for Small- and Medium-Sized Enterprises (GFSME); the Small Business Guarantee and Finance Corporation (SBGFC); and, the Quedan and Rural Credit Guarantee Corporation (Quedancor). These programs were established to stimulate lending to farmers or to operators of small businesses.

This study also reviews policy options regarding loan guarantee programs.

Working on the assumption that loan guarantee programs only generate social benefits if they stimulate lenders to make loans they would otherwise not have made in the absence of the external schemes, the study measured program performance using two frameworks. The benefit-cost framework compares the social benefits and costs and examines how balancing these two factors can lead to successful implementation of the program. The outreach and sustainability framework, meanwhile, focuses on the ability of the program to entice new borrowers and to exist without additional subsidies.

Several sources of information were used to assess the performance of the loan guarantee programs. First, various reports and financial statements supplied by the three loan guarantee

agencies were analyzed. Second, information from the files of the loan guarantee agencies and participating lenders were compiled. Third, the study team interviewed numerous participants in loan guarantee programs in and around Manila, Batangas, Cebu, General Santos and Nueva Ecija.

Findings

Individual Assessments

GFSME. The Guarantee Fund for Small and Medium Enterprises was established in 1984 to provide credit guarantee and other support systems to stimulate creditflow to small and medium enterprises. Its capitalization was done in three

stages: P30 million from the National Livelihood Support Fund in 1984, P100 million from the Agricultural Credit Policy Council in 1991, and another P100 million from the Department of Agrarian Reform in 1994. The total social costs of GFSME have been about P1.236 billion in 1997 prices (**Table I**).

The social benefits and outreach have been calculated in terms of the provision of loan guarantees at an average of about 200 loans a year; a tiny fraction of the number of SMEs in the country. The number of participating financial institutions fluctuates from a low of 17 in 1995 to a high of 52 in 1997.

Table I
Performance Indicators: GFSME

	1997	1996	1995	1994	1993	1992	1991	Average
A. Social Cost								
Guarantee Fund (PM)	500	500	500	500	400	400	400	457
B. Benefits / Outreach								
Number of Borrowers	174	252	461	203	273	71	—	205
No. of Participating Fis	52	40	17	22	40	31		34
Amount of Loan Guaranteed (PM)	707	1,032	939	754	562	186	87	610
Leverage Ratio	1.4	2.1	1.9	1.5	1.4	0.5	0.2	1.3
C. Sustainability								
Net Claims								
Guarantee Claims (PM)	125	100	81	70	60	53	45	76
Recoveries (PM)	64	57	58	49	29	29	21	44
Loan Quality								
Loan Outstanding (PM)	1879	1638	1066	399	223	244		908
Past Due (PM)		81	76	65	25	53		60
Past Due Ratio		0.05	0.07	0.16	0.11	0.22		0.12
Subsidy								
Income (PM)								
Guarantee Fees	14	13	12	9	7	6	5	10
Expenses (PM)	48	31	30	28	24	23	30	31
Operating Expenses	32	26	23	21	17	15	17	22
Administrative	16	5	7	7	7	8	13	9
Net Operating Income (PM)	-34	-18	-17	-19	-17	-17	-25	-21
Income/Expense Ratio	0.29	0.42	0.42	0.32	0.28	0.27	0.17	0.31
D. Memo								
Interest Earnings on Investments (PM)	69	70	60	70	62	69		

The small leverage ratio, the small number of financial institutions that qualify to participate, the small and declining number of loans covered by the guarantee, and the declining value of loans guaranteed suggest that GFSME assistance to small- and medium-sized firms is insignificant and declining. The organization is also unsustainable without periodic infusions of outside funds. The real value of its guarantee fund in 1997 was only 40 percent of the real value of the funds given to the organization. The fees charged on loan guarantees cover only a fraction of the organization's expenses, making it impossible for GFSME to protect the real value of its fund through profits.

SBGFC. The Small Business Guarantee and Finance Corporation was created in 1992 through the Magna Carta for Small and Medium Enterprises to increase the access to financing of small enterprises engaged in agribusiness, processing and manufacturing. It implements both direct lending and guarantee programs. The social costs of SBGFC's loan guarantee program have been P611 million in 1997 prices. The social benefits have been a few hundred guaranteed loans less those loans that would have been made without the guarantee scheme.

Table 2
Performance Indicators:
SBGFC Guarantee Program

	1997	1996	1995	1994	1993	1992	1991	Average
A. Social Cost								
Guarantee Fund * (PM)	440	440	440	440	440	180		388
B. Benefits / Outreach								
Number of Borrowers	178	423	535	561	345	7		374
No. of Participating Fis	106	104	101	63	5	76		
Amount of Loan								
Guaranteed (PM)	26	457	467	454	296	5		336
Leverage Ratio	0.1	1.0	1.1	1.0	0.7	0.0		0.8
C. Sustainability								
Net Claims								
Guarantee Claims (PM)	23	10	15	11	0			9
Recoveries (PM)	2	2	1	5	0			2
Loan Quality								
Loan Outstanding (PM)	411	554	482	410	464			
Past Due (PM)	169	121	92	52	109			
Past Due Ratio	0.41	0.22	0.19	0.13				
Subsidy								
Income (PM)								
Guarantee Fees	5	7	6	5	1	3		4
Expenses (PM)	20	25	88	103	18	3		
Operating Expenses**	16	18	76	85	0	1		32
Administrative***	5	8	11	18	18	3		10
Net Operating Income (PM)	-15	-18	-82	-98	-17	-1		-38
Income / Expense Ratio	0.25	0.27	0.07	0.05	0.07	0.83		0.25
D. Memo								
Interest Earnings on								
Investments (PM)	69	90	194	55	41	22		

* Used paid-up capital when it was implementing only guarantee programs; this is presumably changed from year to year by management

** Assumed 60% of business for 1997-1995 and 100% before 1995

*** Actual for guarantee program

Guaranteed loans by the SBGFC have been decreasing from 561 loans in 1994 to only 178 in 1997 (**Table 2**). In terms of outreach, it has been more successful than GFSME in attracting lending institutions to qualify for participation in its program, but it has been ultra-conservative regarding leverage. The total volume of its guaranteed lending is small and has contracted dramatically after 1996. The past due ratio has grown to 40 percent, threatening the quality of loan portfolio. Moreover, income from guarantee fees covered less than 25 percent of the reported expenses in 1997.

Quedancor. The Quedan Guarantee Fund Board was set up in 1978 to improve the bankability of grains businessmen by strengthening the acceptability of grains warehouse receipt as loan collateral. To date, it implements four guarantee programs. Since Quedancor does not have a separate guarantee fund, it was assumed for the purposes of this study that one-half of the agency's paid-up capital in 1997, or P289 million, constitute the guarantee fund. With this assumption, the social cost of its guarantee scheme is about P371 million in 1997 prices. It must be noted, however, that the institution started operations in 1978 and these calculations do not include losses before 1991.

The assessment of social benefits and outreach was likewise problematic since Quedancor considers as beneficiaries of its loan guarantee programs all of the clients of the cooperatives and marketing intermediaries that received loans guaranteed by Quedancor. This study, therefore, estimates that the social benefits are some fraction of the 4,000 borrowers who would not have received a loan without the scheme, and some fraction of about 30,000 informal borrowers who would have likely received smaller loans, or no loans at all, without Quedancor's loan guarantee cover.

Unlike GFSME and SBGFC, Quedancor uses its guarantee fund to substantially lever lending. Still, the program has only been able to recover about one quarter of the value of the guarantee claims paid, and losses on its guarantee operations have been substantial. It is likely that Quedancor is under-expensing for actuarially-sound loan losses.

In short, Quedancor has possibly realized some additional outreach through facilitating indirect, informal lending by some cooperatives and marketing intermediaries. It has also attracted a significant number of lenders to its programs and used leverage to expand the effect of its loan guarantee fund on lending. These modest achievements in outreach, nevertheless, are threatening Quedancor's survival.

The performance indicators of Quedancor from 1991 to 1997 appear in **Table 3**.

Aggregate Assessment

In order to facilitate the collective assessment of the three loan guarantee programs, all the information were combined to build an "aggregate firm." **Table 4** provides an overview of the performance indicators of the aggregate firm from 1991 to 1997.

Social Cost. The social cost of the aggregate firm came up to about P1.2 billion in 1997 prices. It is estimated that the original value of the guarantee fund is P2.2 billion, of which approximately 45 percent has been dissipated by inflation. If the government were to restore the original value, it would require an infusion of P989 million in current prices.

Social Benefits and Outreach. The determination of benefit and outreach for the aggregate firm was difficult considering that of the 4,374 additional

Table 3
Profitability of Rural Banks

	1997	1996	1995	1994	1993	1992	1991	Average
A. Social Cost								
Guarantee Fund* (PM)	289	263	233	206	155	108		
B. Benefits / Outreach								
Number of Borrowers	4,022	4,123	3,249	1,560	1,287	2,425	1,695	2,623
No. of Participating Fis	203	137	106	93	53	56	108	
Amount of Loan								
Guaranteed (PM)	1,624	1,500	1,572	1,153	768	999	1,450	1,295
Leverage Ratio	5.6	5.7	6.7	5.6	4.9	9.3		
C. Sustainability								
Net Claims								
Guarantee Claims (PM)	68	271	201	123	110	96	85	136
Recoveries (PM) 7		61	55	41	30	27	22	35
Loan Quality								
Loan Outstanding (PM)	837	812	1053	655	440	450		708
Past Due (PM)	276	250	222	186	183	164		213
Past Due Ratio	0.33	0.31	0.21	0.28	0.42	0.36		0.32
Subsidy								
Income (PM)								
Guarantee Fees	13	13	11	6	6	13		10
Expenses ** (PM)	70	51	42	18	31	31		41
Operating Expenses	14	8	6	6	2	7		7
Administrative	56	43	36	12	29	25		34
Net Operating Income (PM)	-58	-38	-31	-12	-25	-19		-30
Income / Expense Ratio	0.18	0.25	0.26	0.34	0.19	0.41		0.27
D. Memo								
Interest Earning on								
Investments (PM)	32	18	18	34	25	9		

* Estimated to be 50% of paid-up capital

** 50% of total expenses

loans that were guaranteed in 1997, half or more would have been made in the absence of guarantee facilities. By any measure, the outreach of the industry has been insignificant and it is likely that social costs have exceeded social benefits by a substantial amount.

Private Costs and Benefits. The bulk of the private benefits is captured by the bureaucracy and the 618 employees who administer the guarantee programs (only a few of whom are poor and, hence, eligible for guarantee cover). This could be a reason for the lukewarm support by banks for loan guarantee schemes and why administrators of these

programs argue strongly for their continuance.

Sustainability. The unrecovered guarantee claims and other operating expenses of the firm far exceed the income from guarantee fees. These actual and pending costs also likely exceed the fees plus the earnings from investments. On this basis, the government funding required to sustain the aggregate firm at its 1997 levels amounts to P320 million annually (P141 million for net claims, P89 million for operating subsidy, and P90 million to keep the real value of the guarantee fund). Otherwise, it is only a matter of time before the aggregate firm will decapitalize.

It should be noted that the earnings on investments can postpone such an eventuality. However, heavy dependence on investment earnings for survival only warrants perverse incentives for guarantee institutions. First, since the programs are earning on the guarantee fund, it is not in their interest to pay guarantee claims quickly which subsequently erodes the credibility of the program. Second, it would also not be in their interest to

expand outreach because this would expose the fund to increasing guarantee claims.

Review of Policy Options

A policy dilemma exists between outreach and sustainability in attempting to improve the performance of loan guarantee schemes. Efforts to expand the disappointing outreach of these

Table 4
Performance Indicators:
Total (GFSME, QUEDAN, SBGFC)

	1997	1996	1995	1994	1993	1992	1991	Average
A. Social Cost								
Guarantee Fund (PM)	1,229	1,203	1,173	1,146	995	688	400	
B. Benefits / Outreach								
Number of Borrowers	4,374	4,798	4,245	2,324	1,905	2,503	1,695	3,121
No. of Participating Fis	255	283	227	216	156	92		205
Amount of Loan								
Guaranteed (PM)	2,356	2,989	2,978	2,362	1,625	1,190	1,536	2,148
Leverage Ratio	1.9	2.5	2.5	2.1	1.6	1.7	3.8	2.3
C. Sustainability								
Net Claims								
Guarantee Claims (PM)	215	380	297	204	170	150	130	221
Recoveries (PM)	73	121	114	95	59	55	42	80
Loan Quality								
Loan Outstanding (PM)	1249	3004	2602	1464	663	694		1613
Past Due (PM)	445	451	390	303	208	216		336
Past Due Ratio	0.36	0.15	0.15	0.21	0.31	0.31		0.25
Subsidy								
Income								
Guarantee Fees	32	32	29	20	14	22	5	25
Expenses	139	107	159	149	72	58	30	114
Operating Expenses	62	51	105	112	19	23	17	62
Administrative	77	56	54	36	54	36	13	52
Net Operating Income	-107	-75	-130	-128	-59	-36	-25	-89
Income/Expense Ratio	0.23	0.30	0.18	0.14	0.19	0.38	0.17	0.24
D. Memo								
Interest Earnings on								
Investments (PM)	171	178	272	259	128	101		185
Total No. of Banking								
Institutions	6,926	6,332	5,569	5,096	4,657	4,296	3,791	5,238
Total Loans Granted to								
Agriculture (PM)	79,090	69,667	62,465	56,492	54,586	56,110	46,110	60,645
GDP Deflator								
(1985=100)	271.40	255.78	237.44	220.90	200.84	187.99	174.18	

Source: Tables 2, 3 and 4

programs will likely worsen the burdensome sustainability problem. On the other hand, initiatives to make these programs less dependent on subsidies will most certainly contract outreach.

Increasing the outreach of the three programs can be achieved through any the following measures:

- Increase the already generous guarantee coverage;
- Reduce the guarantee fees;
- Increase the number of employees to improve the processing time of guarantee applications and the processing of claims;
- Reduce the amount of information required for processing applications or claims; or
- Increase the leveraging ratio and increase the capital base on which the ratio is based.

The sustainability of the three programs, on the other hand, can be improved by undertaking any of the following steps:

- Reduce the operating cost;
- Reduce the risk of loan default;
- Lower the average guarantee coverage below the current mode of 85 percent;
- Increase the guarantee fees from the current average rate of three percent to around 15 percent so as to cover the operating and administrative costs;
- Reduce the number of employees;
- Increase or decrease the amount of information flowing between lenders and guarantee institutions; or
- Decrease the leveraging ratio.

A matrix showing the contrast between policies meant to increase outreach and those meant to increase sustainability appears in Table 5.

Table 5
Policy Matrix

Policy Levers	Current Programs	Outreach-Increasing	Sustainability-Enhancing	
			Cost-Reducing	Risk-Reducing
Level of Loan Guarantee	50% - 100%	Increase	Decrease	Decrease
Guarantee Fee	0% - 3%	Decrease	Increase	?
Number of Employees in Guarantee Agency	A large number	Increase	Decrease	Increase
Amount of Information Flowing in System	Large amount	Decrease	Decrease	Increase
Leverage	Very low	Increase	Decrease	Decrease
Capital Base	Relatively	Small	Increase	Increase ?

CONCLUSIONS AND RECOMMENDATIONS

The following conclusions have been drawn from this study:

- **The outreach of the three programs has been disappointingly limited.** The number of loans being guaranteed is small and the additional number of loans that were stimulated by the guarantee schemes is even smaller.
- **The programs are heavily dependent on subsidies.** Without hefty periodic infusions of government funds, these programs will soon implode.
- **Most policy options that might increase program outreach will further worsen the sustainability and subsidy-dependence problems.** Escalating guarantee claims, excessive operating expenses and inflation are rapidly eroding the real values of these guarantee funds.

The study recommends the following policy options based on its findings:

- **Conduct audit inspection on the three loan guarantee institutions as soon as possible.** The audits should involve actuaries who will document the extent to which future guarantee claims and loan losses are accurately booked. Auditors should also provide estimates of the life of each of these programs without further subsidies.
- **Utilize audit results as policy tool.** The Secretary of Finance should utilize the audit results to decide on the future of the three loan guarantee programs, particularly towards liquidating the guarantee programs and redeploying the remaining assets to other activities that have a more positive impact on poverty reduction.

Based on a report prepared by Thomas M. Fitzgerald, Feliciano L. Miranda, Jr., David S. Murphy and Gerald S. Schulz, Consultants.

For further information, please contact

National Credit Council Secretariat Department of Finance

Assistant Secretary Gil B. Beltran
Ma. Teresa S. Habitan
Joselito Almario
Ma. Lourdes Dedal
Aurora Luz Villaviray
Febe Lim
Erick Tiggos
Nelia Lansang

4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287

Credit Policy Improvement Program Project Management Office

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo

4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph



National Credit Council

Policy Notes

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Deposit-taking Cooperatives: Time to Talk Regulation

IN AN IDEAL WORLD, market discipline is the only form of regulation needed. But the world is far from ideal and regulation by market forces alone is not enough. In financial markets for instance, problems of information asymmetry abound. Hence, we see the government, through the Bangko Sentral ng Pilipinas (BSP), regulating and closely monitoring the activities of deposit-taking financial institutions.

In the field of microfinance, an institution parallel to the BSP is the Cooperative Development Authority (CDA). The CDA is mandated by law not only to develop but to regulate cooperatives. This regulatory function is particularly important for community-based, deposit-taking cooperatives (DTCs) because of these institutions' financial intermediation activities. Moreover, some of these DTCs have a broad membership base, such that their failure

may cause serious economic displacement in a particular community. Thus, to protect members' funds, specific rules must be applied to ensure the financial stability and managerial soundness of cooperatives.

The Current Regulatory Environment

Under the CDA Act (RA 6939) and the Cooperative Code (RA 6938), the CDA's functions may be classified into two broad categories – regulatory and developmental. As a regulatory agency, the CDA is mandated to register cooperatives, thus, providing them legal personality. Complementary to this, the CDA has the power to cancel a cooperative's certificate of registration as well as merge, consolidate, dissolve and liquidate cooperatives.

The Cooperative Code, however, introduces the principle of subsidiarity, making it hard to clearly define the CDA's regulatory function. The principle of subsidiarity essentially recognizes that cooperatives are organized by the private sector and that the cooperative sector will regulate itself. Because of this, the CDA has taken an arms-length approach towards regulating cooperatives. It focuses more on discharging its developmental role and has given minor attention to sound registry and regulation.

Indeed, the CDA's permissive attitude toward the organization of cooperatives led to the phenomenal growth of cooperatives. From only 4,744 in 1990, the number increased to 45,819 in 1997. With so many registered cooperatives needing "developmental" assistance, the CDA faces the daunting task of assisting these cooperatives to the detriment of efficient registry and regulation.

Unfortunately, the developmental role conflicts with the regulatory role. For instance, as part of its developmental role, the CDA promotes cooperatives by providing them "development" or "soft" loans. It then has to turn around and regulate cooperatives' lending and deposit-taking activities. It, thus, faces a dilemma that stems from having inconsistent objectives lodged within it. As may be attested

by the defunct Central Bank of the Philippines, objectivity cannot be expected of a regulator who is, at the same time, deeply involved in the development and promotion of the institutions it regulates. In the case of the Central Bank, the problem was resolved by taking its developmental function away.

The CDA's developmental role consists of conducting management training programs for cooperatives and providing them financial assistance through grants, donations (including those from Congressional Initiative Act) and subsidized loans (from the government's directed credit programs). The latter deserves special attention.

Directed lines of credit have been referred to as the "poison pill" of credit cooperatives for at least three reasons:

- a) cooperatives end up raising funds for lending by borrowing from subsidized lines of credit instead of mobilizing savings from members;
- b) directed lines of credit are often used for high risk lending leading to repayment difficulties, high operating costs and loan write-offs; and

- c) borrowers often perceive that government funds need not be repaid so that members of the credit cooperative end up absorbing the loss.

Based on interviews with CDA and cooperative officials, it would seem that quite a number of cooperatives were organized for the sole purpose of serving as conduits for directed credit programs. The interviewees revealed that many of these cooperatives disbanded once they received the credit or when the source of credit had dried up.

Assessment of CDA Regulation of Cooperatives

At present, the CDA limits its regulatory role to registration and to some extent, monitoring. Yet given the number of non-reporting cooperatives and the information that many, particularly those organized purely as conduits of directed credit programs or donations, have failed, it is important to assess the effectiveness of existing regulatory set-up. The review yielded the following observations:

Registration

1. Recognizing that “cooperation is a right”, the current regulatory systems and

procedures seem to be biased for approving applications for registration. CDA's failure to act on an application within 30 days constitutes an approval. If the CDA denies the application, an appeal may be sent to the Office of the President which, if not acted upon within 90 days, will also constitute an approval. There has been no denial to date.

2. There is virtually no entry barrier as the minimum capitalization for a cooperative is a mere P2,000. Registration requirements are ceremoniously submitted, patterned after existing documents of other cooperatives. There is no validation made on whether the cooperative is legitimately organized, or whether there are no duplications in particular areas. Not even the economic survey is validated for feasibility.
3. There is a common perception that a large number of cooperatives in CDA's registry are inactive. Indeed, a 1997 survey indicated that only 65% (or 29,898) of the more than 45,000 cooperatives in the CDA's registry are operating.

Monitoring

4. As part of its monitoring efforts, the CDA requires cooperatives to submit annual reports and audited financial statements 60 days from the end of the fiscal year. However, only 38% of registered and operating cooperatives complied with the requirement for submission of annual reports and only 34% submitted their audited financial statements.
5. There are no clear sanctions for non-reporting. The gravest sanction, cancellation of registration, is not being applied. There is no evidence of an established system to monitor nor to sanction inaccurate or late reports.
6. Processing of cooperative statistics has been limited to consolidation without verification and checks for accuracy.
7. The CDA has a chart of accounts for different types of cooperatives but does not have a standard chart of accounts specifically developed for DTCs. Moreover, the existing chart of accounts has not been formally adopted as the standard form for reports. Hence, it is not used for monitoring.

8. There is no reliable source of information that would give an accurate estimate of the size of DTCs. The CDA's database contain some 24,037 operating cooperatives. But because the CDA is unable to separate assets used for financial intermediation activities in multipurpose cooperatives (MPCs) from assets for other activities, the number of DTCs is basically undetermined. Information on community-based DTCs is necessarily limited to 462 credit cooperatives and 6,658 MPCs.

Inspection

9. The law does not explicitly mandate the CDA to inspect cooperatives. Hence, the CDA does not consider inspection a major activity. While the CDA conducts examinations of cooperatives' financial records, it does so only cursorily and is not concern with proper and accurate booking of transactions. Interviews with both cooperatives and CDA officials reveal that inspection has been limited to brief visits by the staff of the CDA.

Performance Rating

10. The CDA's rating system, the "Policy Instructions on Cooperative Classification

Information System”(CCIS), is not effective in assessing the quality of operations of cooperatives, particularly in terms of how well a cooperative is able to service member needs. The CCIS indicators do not provide users a clear picture of how well a cooperative is performing either financially or socially. It assigns a heavy weight to high growth of membership and assets as well as to profitability but not to such factors as capital adequacy, asset quality, soundness of the credit process or capability of management. Overall, it lacks the depth of the CAMEL or the PEARLS rating systems.

Enforcement of rules

11. The CDA was vested authority and has been able to issue rules and regulations to implement the provisions of the law. The law, however, does not explicitly clothe CDA with enforcement powers, except for actions leading to cancellation of registration (for non-submission of reports and violation of laws). Even here, enforcement has been lenient.

Dissolution and Liquidation

12. The CDA has drafted a comprehensive manual covering the dissolution and

liquidation of cooperatives, differentiating between voluntary and involuntary dissolution. However, despite the large number of cooperatives that are not complying with the reportorial requirements, the CDA does not take immediate action to liquidate them.

RECOMMENDATIONS

Strengthening the regulatory framework for cooperatives, particularly for DTCs, is becoming more important as the sector's contribution to the economic development of the country grows. There is a need to adopt policies conducive to effective regulation that is based on greater transparency in information and stricter and clearer accountabilities of key people, namely: the regulators, cooperative management, members of the board of directors, external auditors and even asset appraisers. The law, rules and regulations should be checked for clarity in establishing these accountabilities.

While these things will take time to achieve, the CDA can immediately:

Registration

1. Purge inactive cooperatives from the registry, classifying them as cooperatives “in process of cancellation”. Cooperatives that have not filed their audited financial statements should be classified as “in process of liquidation” until they have filed current reports;
2. Make registration of DTCs more selective, with higher minimum paid-up capital, more rigorous analysis of the economic survey, and so forth; it may want to consider implementing a license for deposit taking operations; and
3. Shift from a goal of registering more cooperatives to a goal of enhancing quality of cooperatives.

Monitoring

4. Compile basic financial information on all DTCs (assets, loans, passbook savings, share capital, external credits, etc.) and classify them by asset size; and

5. Establish and enforce minimal accounting standards in DTCs;

Developmental work

6. Discontinue credit programs to cooperatives because of the conflicting objectives of regulation and credit extension.

On top of these, the CDA should, within the next two years, be able to:

1. Issue and enforce a specialized, uniform chart of accounts and accounting rules for DTCs, disseminating these to concerned organizations;
2. Require all DTCs to segregate accounting for financial intermediation from other activities and provide assistance to multi-purpose DTCs in doing this;
3. Require all DTCs, as part of their annual report to the CDA and to members, to calculate a simple set of CAMEL-based indicators derived from the uniform accounting system;
4. Develop a database system on DTCs, adequate for monitoring and feedback;

5. Discontinue development activities with DTCs; instead, upgrade its technical capability to carry out its regulatory function; and
6. Encourage the development of informal examination and supervision schemes (e.g., by managers, the Board of Directors, secondary and tertiary cooperative organizations or external auditors) in the cooperative sector.

In tandem with these reforms in the CDA, the NCC, as the government's credit policy arm, needs to immediately rationalize all existing directed credit programs. This will ensure that DTCs rely on the savings and share capital of their members as sources of loanable funds. Over the medium-term, it should be able to:

7. Achieve policy maker concurrence on the constitution or transformation of CDA, or a part of CDA, into a DTC regulatory body with greater technical ability and political independence;
8. Initiate legislative amendments to the Cooperative Code to:

- Vest regulatory responsibility and authority for DTCs in CDA or another appropriate body;
- Include in the regulator's mandate the authority and responsibility to analyze the financial reports submitted by DTCs for compliance with the minimum standards. It should be emphasized that to avoid violating the principle of subsidiarity, the standards should be set in consultation with the cooperatives;
- Authorize the examination of DTCs by the regulator; and
- Increase the accountability of DTC auditors, managers, and Boards of Directors for financial reports.

Based on a report prepared by Lee Arbuckle, Rescina Bhagwani, Gilberto M. Llanto and Ma. Piedad S. Geron, Consultants.

For further information, please contact

**National Credit Council Secretariat
Department of Finance**

Assistant Secretary Gil S. Beltran
Ma. Teresa S. Habitan
Joselito Almario
Ma. Lourdes Dedal
Aurora Luz Villaviray
Febe Lim
Erick Tipgos

**4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287**

**Credit Policy Improvement Program
Project Management Office**

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo

**4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph**



National Credit Council

Policy Notes

JULY 1999

NO. 99-02

Policy Framework for Rationalizing Directed Credit Programs

Directed credit programs (DCPs) have been around for decades. These are subsidized loan programs of the government (a) targeted toward a specific sector; (b) with funding coming from sources external to the implementing organization (usually budgetary allocation, grants or loan proceeds from donor organizations), and (c) with interest rates on loans below market rates. Unlike grants, which are lump-sum transfers from the donors to the beneficiaries, DCPs entail loan servicing costs.

Rationale behind DCPs

The government created DCPs to provide low-income people access to formal credit. The target clientele are usually small-scale borrowers, e.g., small farmers and fisherfolk, microentrepreneurs, etc., who have been excluded from the formal banking system because of high transaction cost of small loans, asymmetry of information in credit markets and perception of high credit risks. Thus, these small-scale borrowers have to rely almost completely on informal credit, which come at enormously high interest rates, to finance their various activities. Through the directed credit programs, the government hopes to give them a better alternative to the informal moneylenders.

The costs of DCPs

The use of DCPs has been justified on such equity considerations. However, because of high loan administration costs and low loan recoveries, the continued implementation of DCPs has saddled the government with a huge fiscal burden. Worse, grants are not fiscal costs; they form part of "revenue". DCPs are hidden costs - i.e., the interest subsidies and administration costs are not explicitly reflected in the government's budget. Moreover, DCPs have created distortions in the economy because:

- a. by targeting a specific sector, they give preferential treatment to one sector over other sectors on the basis of the former's perceived economic vulnerability;
- b. by continually relying on external funding from the government and other donor institutions, they drain scarce resources that could be put to better use elsewhere (e.g., rural roads, basic health and nutrition services, basic education, etc.); and
- c. by giving out loans at lower-than-market interest

rates, they distort relative prices resulting in inefficient resource allocation.

Moreover, because DCPs form part of the financial system, the presence of massive government-subsidized credit is one sign of a financially-repressed economy. Credit subsidies create incentive compatibility problems on the part of credit intermediaries (by displacing efforts to mobilize deposits) and borrowers (by perpetuating a dole-out mentality). Hence, they not only do not really improve the lot of the “disadvantaged” sectors, they also weaken the banking system.

Policy inconsistencies

Recognizing the ills of financial repression, the government embarked on the liberalization of financial markets in the 80s, lifting interest rate ceilings as well as terminating and consolidating DCPs. The basic government thrust is to rely on market mechanism in the allocation and pricing of financial resources, and to promote and maintain a viable and sustainable financial market. But even as the government espoused free market principles, it implemented various measures that tended to undermine market-oriented financial and credit policies. Congress also created subsidized credit programs that added to the proliferation of DCPs. Some of these policy inconsistencies include the following:

1. In 1986, the Aquino administration abolished a number of DCPs and consolidated 20 agricultural credit programs under the Comprehensive Agricultural Loan Fund (CALF). While this was being done in the agriculture sector, DCPs targeted at other sectors proliferated. These included programs for micro-entrepreneurs, the poor, women, livelihood programs, etc.
2. Following the adoption of market-determined interest rates in the 80s, the Central Bank of the Philippines abolished the preferential pricing of credit

to specific sectors and stopped providing rural banks special time deposits at below-market rates of interest. Recent legislation, however, such as RA 6657 (Comprehensive Agrarian Reform Law), RA 7607 (Magna Carta for Small Farmers), and RA 7900 (on high-value crops) resurrected caps on lending rates. Moreover, a number of DCPs, especially those funded out of government appropriations and congressional pork barrel, impose interest rates that are below the prevailing market rates.

3. Under a liberalized credit environment, the government should refrain from interfering directly with banks' credit decisions. However, the Agri-Agra Law (PD 717) and the Magna Carta for Small Enterprises (RA 6977) mandate financial institutions to allocate certain percentages of their loan portfolio to targeted sectors.
4. When agricultural DCPs were being terminated and consolidated, the government set up loan guarantee institutions to entice private banks to lend their own funds to small borrowers on the basis of a credit guarantee provided by government. However, despite the loan guarantees, small borrowers continue to face problems of accessing credit from formal sources.

Clearly, there is policy inconsistency. The government and the Bangko Sentral ng Pilipinas have ostensibly followed market-oriented financial and credit policies. However, the government and Congress have at the same time created a large number of subsidized directed credit programs, many for political reasons. A number of government agencies have involved themselves in direct lending which is not their chief mandates. Interest rates were never free to move with the prevailing market conditions and mandated loan allocation has forced banks to allocate loan funds that did not reach the intended beneficiaries.

Some facts about existing DCPs

Despite past policy pronouncements to terminate and consolidate DCPs, a survey conducted in 1997 revealed that there are 86 ongoing DCPs in various sectors of the economy. Figure 1 summarizes these 86 programs and shows the varied modes of program implementation. The complexity of these programs is such that tracing program funds from source to end entails moving through a labyrinth of credit conduits of varied shapes and sizes. Overall, the survey found that the DCPs (a) have low outreach, (b) are financially unsustainable and (c) exact an enormous fiscal cost on the government. More specifically, the results of the studies point to the following:

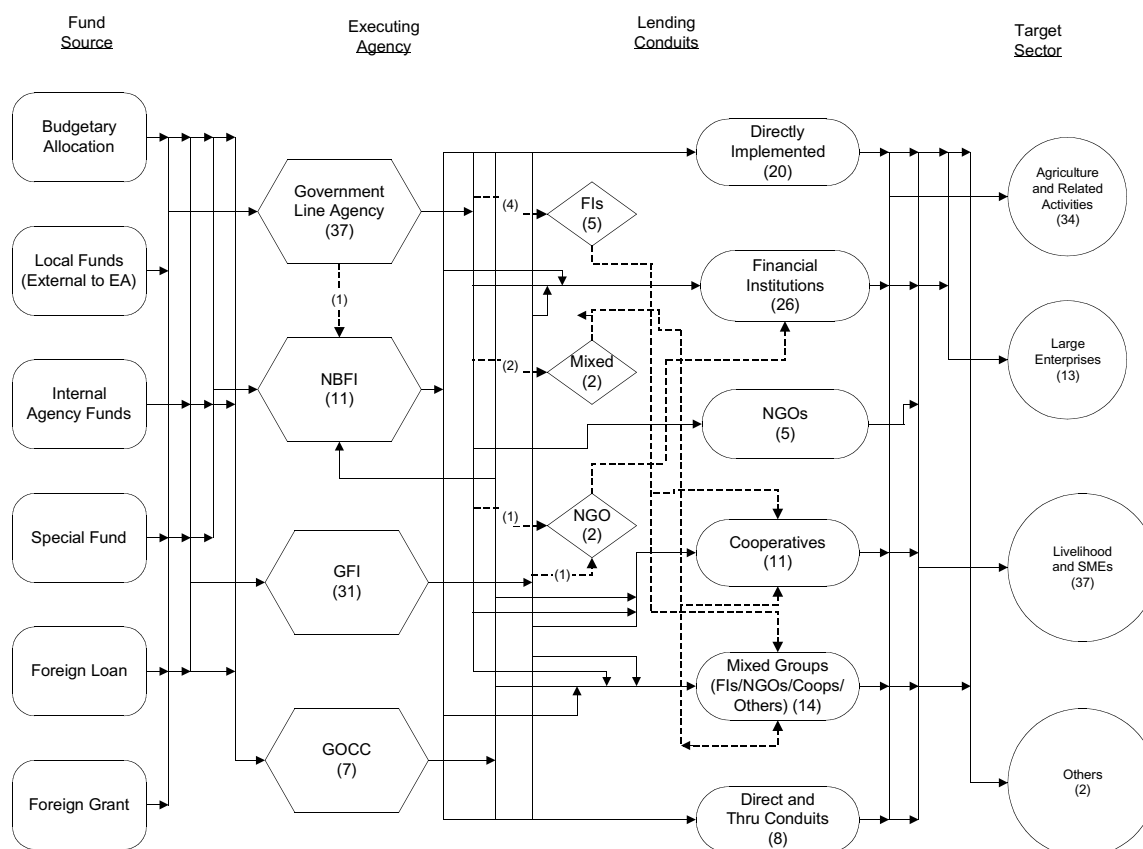
1. There are almost as many DCPs in agriculture (33) as in industry (34). The majority of DCPs source

their funds from budgetary allocation and donor loans and grants. The initial fund allocation for 63 DCPs amounted to as much as P40.5 billion, equivalent to almost 2% of gross domestic product in 1996.¹

2. Not all the DCPs have high outreach. Overall, DCPs implemented by government non-financial agencies (GNFAs) have lower outreach compared to those implemented by government financial institutions (GFIs). For 1995-96, DCPs implemented by GNFAs reached an average of 22,721 beneficiaries per program compared to 38,332 beneficiaries per program of GFIs. Moreover, the average repayment rate of DCPs implemented by GNFAs is only 73% as against the 92% repayment rate of DCPs implemented by GFIs.²

Figure 1

Flow of Fund Chart for Directed Credit Program



3. GNFA's lack the capacity to manage credit programs. The credit programs they manage are supplementary to their primary mandates and thus, sustainability or financial efficiency in implementing their respective DCPs becomes second priority. Hence, none of the DCPs managed by GNFA's earns enough from lending operations to fully recover lending costs.³
4. Directed credit programs are burdened by large default subsidies which indicate that many of these programs may not really be that effective in improving the lot of the poor. One estimate put the total default subsidies of 20 DCPs at P507.3 million in 1996, which, if explicitly recorded, would have reduced that year's national government budget surplus by 8%.⁴
5. A larger unaccounted expenditure item consists of interest rate subsidies. In 1996, interest subsidies on 20 DCPs totaled P1.4 billion, which again, if explicitly treated as expenditures, would have cut 22% off the 1996 budget surplus. Worse, these subsidies are captured by the financial institutions, cooperatives and NGOs acting as conduits, since they get the DCP funds for on-lending at below market rates. Many of the end-users, in contrast, pay market rates of interest.⁵
6. Mandated credit programs have not really been instrumental in providing credit to the target clientele. The compliance rate of the Agri-Agra Law is only 17% as against the mandated 25%, with most banks (except rural banks) not complying with the agra

requirement. The agri requirement, on the other hand, is redundant since the scope for profitable agricultural lending is substantial and generally complied with. Likewise, with the exception of foreign banks, the mandatory requirement for small enterprises is sufficiently complied with and is unnecessary. In a way, non-faithful compliance with the loan quota requirements saved banks from incurring increased default and operating costs. These costs would have been borne by depositors in terms of lower deposit rates, the banks in terms of lower profits and borrowers in terms of higher borrowing rates.⁶

Rationalizing DCPs

There are numerous DCPs currently being implemented, most of which have not achieved their intended goals. Unless something is done, the government faces the prospect of forever allocating resources to subsidize the programs. The experience with DCPs demonstrates that these programs have failed to satisfy two important criteria - effective outreach and financial sustainability.

The first is the equity criterion: the government's credit programs should reach the targeted clientele. Hence, there should be a deliberate effort to reach the low-income clients or small-scale borrowers and to satisfy their credit demand. The larger the number of such small borrowers served, the higher is outreach.

The second is the efficiency criterion: the credit programs should be self-sustaining and free from hidden

¹ Gilberto M. Llanto, et. al., "Directed Credit Programs in the Philippines: The Experience and Policy Reform Issues," NCC-CPIP Working Paper 1, July 1997.

² Ibid.

³ Mario Lamberte, et.al., "Assessment of the Role and Performance of Government Non-financial Agencies in Implementing Directed Credit Programs," NCC-CPIP Working Paper 2, December 1997.

⁴ Dale W. Adams and Joseph Y. Lim, "Interest rates, subsidies and directed credit programs in the Philippines," NCC-CPIP Working Paper 7, December 1997.

⁵ Ibid.

⁶ Felipe Medalla and Johnny Noe Ravalo, "Impact of Mandated Credit Programs," CPIP Working Paper 8, December 1997. Also, Clarence Dingcong, "Review of Financial Laws and Regulations Affecting the Provision of Financial Services to the Basic Sectors," NCC-CPIP Working Paper 4, 1997.

or overt subsidies. Hence, it should not rely on artificially-priced, concessionary external funds (either from donors or from the government) which will not always be available in view of competing use for those funds and the changing objectives of fund sources. The lending institution should, thus, cover the cost of administration and financial operations through the revenues generated from the provision of credit.

The criteria of outreach and sustainability and their underlying principles call for minimum government intervention in providing financial resources to the small borrowers. The former paradigm of earmarking government resources as loan funds to target clientele and providing these at below market rates through government agencies is no longer appropriate. In light of the experience with DCPs, the government should re-examine its role in the credit markets and deploy its scarce resources where the marginal benefit to society will be greater than the marginal cost to it. This is best achieved in a liberalized and market-oriented economy

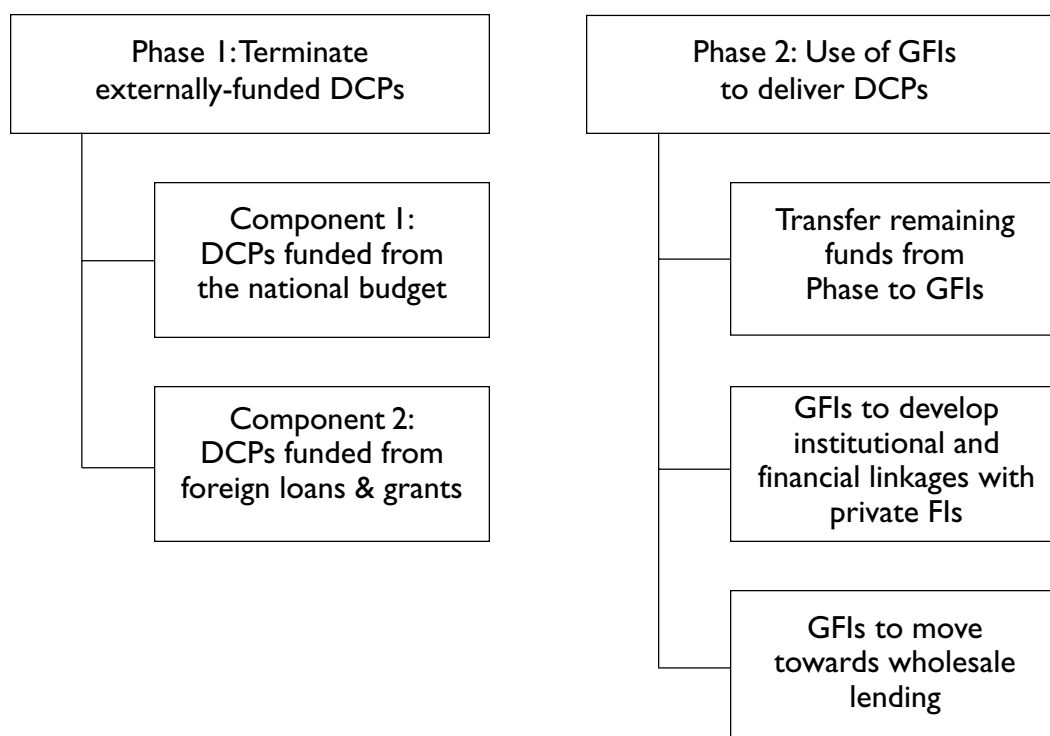
where the private sector plays the major role and the government provides the enabling environment (through the appropriate policy and regulatory framework) for the efficient functioning of markets.

The task ahead

Given the above observations on ongoing DCPs and applying the criteria of outreach and sustainability, the National Credit Council, in coordination with other concerned agencies, should pursue the following policy strategies:

1. **Rationalize DCPs.** The government should immediately put a stop to the creation of DCPs, terminate existing programs implemented by government non-financial agencies and transfer the remaining funds to government financial institutions (GFIs). More specifically, the rationalization plan involves:

Rationalization Plan



2. **Adopt market-based interest rate.** GFIs should charge market rates on wholesale loans, that is, cost recovery rates that fully cover financial and operational costs.

3. **Formulate and adopt alternative mechanisms for the delivery of credit services.** Private financial institutions should be encouraged to use innovative lending technologies that allow the extension of small-sized loans with no collateral requirements and with repayment terms matching borrowers' cash flow. To encourage private financial institutions to go into this type of lending, the government should provide a supportive policy environment, including an appropriate regulatory and supervisory environment.

For further information, please contact

**National Credit Council Secretariat
Department of Finance**

Assistant Secretary Gil S. Beltran
Ma. Teresa S. Habitan
Joselito Almario
Ma. Lourdes Dedal
Aurora Luz Villaviray
Febe Lim
Erick Tiggos

4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287

**Credit Policy Improvement Program
Project Management Office**

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo

4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph



National Credit Council

Policy Notes

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The Agro-Industry Modernization Credit and Financing Program: *An Alternative to Directed Credit Programs in Agriculture*

It has been 13 years since President Corazon Aquino issued Executive Order 113, abolishing 20 subsidized directed credit programs (DCPs) in the agricultural sector and consolidating them under the Comprehensive Agricultural Loan Fund (CALF). Since then, the government has found various reasons to create more subsidized credit programs, directed both at the agricultural and non-agricultural sectors. By 1997, there were already 86 DCPs, divided roughly equally between the agricultural and non-agricultural sectors.¹ Recent studies revealed that just like the programs of the 70s and early 80s, the present crop of DCPs (a) have low outreach, (b) are financially unsustainable and (c) exact an enormous fiscal cost on the government.² Thus, there is a need for the government to rationalize these DCPs.

Given the findings of the studies, it was recommended that the rationalization process proceed on the basis of how well existing DCPs perform with respect to two criteria: effective outreach and financial sustainability.³ Using the twin criteria, the overall suggestion was to: (a) disallow government line agencies from directly implementing DCPs; (b) adopt market interest rates; and (c) adopt innovative lending technologies suited for small-sized loans.

The AFMA and the AMCFP

In light of these recommendations, the government implemented the rationalization program of DCPs starting with the agricultural sector. Republic Act 8435 or the Agriculture and Fisheries Modernization Act (AFMA) spells out the government's basic credit policy as follows :

1. To provide small farmers and fisherfolk access to credit as a means to alleviate poverty and promote growth;
2. To adopt market-based interest rates; and
3. To encourage active private sector participation in the rural financial system.

¹ Directed credit programs refer to subsidized loan programs of the government (a) targeted toward a specific sector, (b) with funding coming from sources external to the implementing organization (usually budgetary allocation, grants or loan proceeds from donor organizations), and (c) with interest rates on loans below market rates.

² A series of studies on the efficiency and effectiveness of these directed credit programs were conducted under the Credit Policy Improvement Program Project of the National Credit Council from 1997-98.

³ Gilberto M. Llanto and Ma. Piedad Geron, "Policy Framework for Rationalizing Directed Credit Programs," Paper prepared under the Credit Policy Improvement Program Project, DoFINCC, 1998.

Towards this end, the AFMA directed the Department of Agriculture to phase-out 42 DCPs in the agricultural sector (including the Comprehensive Agricultural Loan Fund) within four years and to transfer all loanable funds to a newly-created facility called the Agro-Industry Modernization Credit and Financing Program (AMCFP). The program was prepared by the Agricultural Credit Policy Council (ACPC) and the National Credit Council (NCC) in consultation with the public.

The AMCFP is a (a) market-oriented credit and financing program (b) designed to enhance the participation of private financial institutions in the rural credit markets and, thus, (c) give “smallholders” (i.e., small farmers and fisherfolk, microentrepreneurs) greater access to formal credit. The program seeks to correct the distortions and inefficiencies created by government DCPs, while ensuring the continued supply of credit to the “smallholders”.

The AMCFP as alternative to DCPs

While the AMCFP shares with DCPs the noble goal of providing the poor access to credit, it differs from the usual DCPs in many respects, the most crucial of which is that it aims for efficiency and sustainability. The AMCFP recognizes the fact that a successful credit program must have both effective outreach and financial sustainability. DCPs never aimed at financial sustainability. They were simply intended to channel subsidized credit to target beneficiaries. However, a program that has high outreach but is donor or government dependent is not viable and funds would best be given out as grants to cut down on loan servicing costs. On the other hand, a program with financial sustainability but low outreach to the poor would not need government support as banks would be all too willing to provide the service. Thus, the AMCFP, by requiring both effective outreach and financial sustainability, has the makings of a successful government credit program. More specifically, the following features of the AMCFP distinguish it from DCPs, making it a superior facility.

Government line agencies will not be involved in direct program implementation.

The AMCFP recognizes the fact that government line agencies should not implement credit programs because: (a) their employees are not trained to do screening, evaluation and monitoring of loan usage; and (b) financial sustainability of the credit programs will always be a secondary concern for these agencies (since implementing the programs is not their primary mandate). Hence, the AMCFP gets government non-financial agencies out of credit programs and puts them in an area where their comparative advantage lies – providing support services. Thus, the AMCFP mandates the Department of Agriculture to coordinate with other government agencies in providing the following: infrastructure, research, training, policy development, advocacy and fund sourcing from donors.

Credit decisions are vested solely in banks and microfinance institutions.

The AMCFP designates government and private financial institutions as well as viable credit cooperatives and non-government organizations (NGOs) as retail lending units. Once AMCFP funds are transferred to these institutions (in the form of loan contracts with market-based interest rates), they will take charge of disbursing the funds following their own credit policies. The participating financial institutions will, thus, make all the credit decisions from screening borrowers and prescribing terms and conditions to monitoring loan usage and collecting loan proceeds. More importantly, they will absorb all the credit risks. Hence, there will be no political pressure on the financial institutions to lend to a particular individual or group. Inefficiencies in fund allocation will, therefore, be minimized.

Use of market-based interest rates. The AMCFP prescribes that interest rates charged on loans be market-determined at every stage of the lending process – from the government to wholesalers, from wholesalers to retailers, and from retailers to end-borrowers. This recognizes the fact that many DCPs have failed because the interest rates charged on loans were not enough to cover the programs’ administrative

and operational expenses. Hence, there will be no cap on the spread that both wholesalers and retailers can charge. For the more efficient conduits, the final interest rate will be lower. For those whose administrative and operational costs are high, the final interest rate will be higher. The market will obviously exclude them as future retailers. The AMCFP will, thus, leave it to competition among the participating financial institutions to steadily bring interest rates down. Borrowers are free to choose from which participating financial institution they want to source AMCFP funds. The competition among the financial institutions will not only be in terms of price, but also in terms of service and familiarity with potential borrowers.

What is important here is that by allowing financial institutions to charge interest rates that reflect their costs, the AMCFP ensures its own keep. Unlike DCPs, it will not suffer declining loan funds over time, leading to a situation where it will forever be dependent on budgetary allocation or donor grants. The use of market rates is, thus, the key to the AMCFP's sustainability and eventually, higher outreach. Moreover, market interest rates need not mean high interest rates, especially with competition driving rates lower.

Fund allocation is demand-driven. Within agriculture, the AMCFP does not target any particular sector (sector-neutral), commodity (multi-commodity), or activity (multi-track). Fund releases will depend on the absorptive capacity of the Fund Managers, which, in turn, will depend on loan demand from the "smallholders". This contrasts sharply with the supply-led strategy of DCPs where "disadvantaged" sectors are first identified, then funds earmarked regardless of the creditworthiness or particular need of the targeted borrower. The demand-driven feature of the AMCFP will make it more responsive to real credit needs of rural "smallholders". As such, AMCFP funds will be more effectively used and resource wastage lessened.

Innovative credit delivery mechanism. The AMCFP utilizes banks (government and private), cooperatives and NGOs as credit channels to reach

as wide a group of beneficiaries as possible. Mindful of the large delivery network of the Land Bank of the Philippines (LBP) and the Development Bank of Philippines (DBP) as well as these banks' comparative advantage in wholesale lending, the AMCFP has designated the two banks as wholesalers of AMCFP funds. Similarly, the AMCFP acknowledges the NGOs' and the cooperatives' expertise in rural microlending and welcomes these institutions as retailers of AMCFP funds. Thus, rather than follow the DCP approach of direct delivery by government agencies, the AMCFP strategy of using the comparative advantage of different types of institutions in credit delivery increases the outreach potential of the program.

Concluding remarks

The AMCFP ushers in a new era in the government's continuing goal of providing small-scale agricultural borrowers access to formal credit. The facility holds the promise of successful government intervention in rural financial markets. Nonetheless, the government is still just taking the initial steps in implementing the AMCFP and care should be taken that no major slippage happens, especially in the next four years when existing DCPs will be phased out and funds consolidated under the AMCFP. It is important that the key features distinguishing the AMCFP from DCPs are kept intact to ensure the program's success.

Already, initial discussions with major stakeholders - financial institutions, NGOs, cooperatives, farmers, fisherfolk, microentrepreneurs - have brought out a continuing clamor for lower interest rates. It is crucial for everyone concerned to understand that lower rates are not necessarily subsidized rates. Lower interest rates can be the result of competition that the AMCFP will foster in the marketplace. Thus, it is important that the rationale behind market interest rates is explained fully and clearly to all, noting that in any government credit program, financial sustainability and outreach are inextricably linked and that the former is a necessary condition for higher outreach.

For further information, please contact

**National Credit Council Secretariat
Department of Finance**

Assistant Secretary Gil S. Beltran
Ma. Teresa S. Habitan
Joselito Almario
Ma. Lourdes Dedal
Aurora Luz Villaviray
Febe Lim
Erick Tiggos

*4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287*

**Credit Policy Improvement Program
Project Management Office**

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo

*4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph*



National Credit Council

Policy Notes

SEPTEMBER 1999

NO. 99-04

Executive Order 138: Towards Sustainable Financial and Credit Policies

At a time when the government's widening budget deficit is hogging headlines, Executive Order (E.O.) 138, signed on August 10, 1999, is welcome news. The E.O. is part and parcel of the government's thrust to rationalize financial and credit policies. It comes on the heels of the Agriculture and Fisheries Modernization Act (AFMA) which provides for the phase-out of directed credit programs in the agriculture sector. The E.O. ensures that the same policy principles espoused in the AFMA are equally applied in other sectors, thus, leveling the playing field for all sectors.

With the implementation of the E.O., the government will realize cost savings in terms of (a) on-budget fund allocation for directed credit programs and (b) off-budget interest and default cost subsidies. The freed up resources can be put to better alternative uses that increase the economy's efficiency and absorptive capacity. At the same time, adoption of the policy guidelines will remove government subsidies that distort the financial system.

Introduction

The government has long advocated the adoption of market-oriented financial and credit policies to promote and maintain a viable and sustainable financial market. Hence, as early as the

1980s, the government sought to end financial repression through, among others, lifting interest rate caps on savings and loans. The continued implementation of subsidized credit programs up to the present directly conflicts with and undermines this policy thrust.

There are currently 82 government credit programs directing subsidized loans to various "disadvantaged" sectors of the economy (Table 1). A series of studies done under the Credit Policy Improvement Program (CPIP) of the National Credit Council (NCC) revealed that these programs lead to huge fiscal costs (the bulk of which are "hidden" or off-budget) with many of them doing poorly as well in terms of outreach to targeted clients.

In 1996, fiscal resources allocated to fund 63 directed credit programs reached 1.8% of GNP. On top of this, losses associated with interest and default subsidies (on 20 programs with available data) reached P1.9 billion. Repayment rate reportedly averaged only 70% to 80%. Moreover, government non-financial agencies, on the average, have lower outreach compared to government financial institutions. In 1996, programs implemented by GNFA's reached an average of 13 thousand beneficiaries per program compared to 18 thousand for programs implemented by GFIs.

Overall, the NCC studies indicate that many of the current programs do not satisfy two important and inter-related criteria of successful credit programs – effective outreach and financial sustainability. This is because many of the programs are:

a) Implemented by government non-financial agencies. These agencies do not have the expertise and capability to do credit screening and loan servicing. Moreover, since managing credit programs plays only a supplementary role to their primary mandates, sustainability or financial efficiency of the programs is of secondary importance to them.

b) Granted at subsidized interest rates. Since the interest rates charged are not enough to cover financial and operating costs, the credit programs are doomed to failure from the start. They have to rely on continuous fund infusion

from the government or donor institutions to continue operating. These have affected government's priority projects such as the delivery of basic services and the implementation of public infrastructure projects.

c) Plagued by low loan recovery. On the one hand, borrowers tend to view the credit funds as government dole-outs and do not bother to repay the loans. On the other hand, not only are employees of government line agencies not trained to handle loan monitoring and collection, they are also, at times, under political pressure to grant loans even to non-qualified borrowers.

Without financial sustainability, initial funding for credit programs cannot be recycled. The results are continuing dependence in the government for loan funds and a very limited outreach to a select few. E.O. 138 seeks to correct these weaknesses.

Table 1: Summary Information on Directed Credit Programs

Programs / Sector	Implementing Agency	Legal Basis	Fund Source
I. Government Non-financial agencies			
<i>Small and Medium Enterprises (5)</i>			
1. New Invention Guarantee Fund (NIGF)	DOST	RA 7459	DBP
2. Assistance to Microenterprise (AMED)	DTI-BSMBD	EO/ MOA	Budgetary allocation
3. Countrywide Industrialization (CIF)	DTI-BSMBD	RA 7459	Budgetary allocation
4. Microenterprise Development (MEDP)	DTI-BSMBD	MOA	Budgetary allocation
5. Sectoral Livelihood Program (SLP)	DTI-BSMBD	EO/ MOA	Budgetary allocation
<i>Agriculture (26)</i>			
6. Fisheries Sector Program (FSP)	DA-ACPC	Loan Agreement, MOA	ADB, OECF
7. Gintong Ani Rice & Corn	DA-ACPC	EO 113, RA 7607, MOA	Budgetary allocation
8. Gintong Ani II Coop Banks	DA-ACPC	MOA	CALF, Budget alloc.
9. Gintong Ani Farm Mechanization	DA-ACPC	MOA	CALF
10. Integrated Rural Financing (IRF)	DA-ACPC	MOA	CALF
11. Multi-livestock Dispersal (MLDLP)	BAI	Department Order	Proceeds fr: RP-Japan Food
12. Livelihood Enhancement (LEAD)	DA-NAFC	EO 116, D.O.	Production Program
13. Carabao Development (CDFP)	PCC	MOA	Budgetary allocation
14. Catanduanes Agri Dev't (CatAg)	DA-SCO/PMO	Financing Agreement	EU (Grant)
15. C.Cordillera Agri Program (CECEAP)	DA-SCO/PMO	Financing Agreement	EU
16. Caraballo & S. Cordillera (CASCAD)	DA-SCO/PMO	Financing Agreement	EU
17. Aurora Integrated Area Dev't (AIADP)	DA-SCO/PMO	Financing Agreement	EU
18. Southern Mindanao Agri (SMAP)	DA-SCO/PMO	Financing Agreement	EU

Table I cont.

Programs / Sector	Implementing Agency	Legal Basis	Fund Source
19. Western Samar Agri (WASDP)	DA-SCO/PMO		EU
20. Cooperative Marketing (CMP)	CDA	RA6939,MOA	Collection from old CMP
21. Coop Development Loan (CDLF)	CDA	RA6939	Collection from old CDLF
22. Coop Support Fund (CSF)	CDA	RA6939	Collection from SNSP
23. Special Loan Fund (SLF)	CDA	RA6939	Collection from CRDLF
24. CDF / CIA	CDA	RA6939	CDF/ CIA
25. KMI Peasant Development Fund	DAR	RA6657, MOA	Budgetary allocation
26. Countryside Partnership (CPS)	DAR	RA6657, MOA	ARF
27. CAP-PBD	DAR	RA6657, MOA	ARF
28. CARP-Barangay Marketing (BMC)	DAR	RA6657, MOA	ARF
29. Program for Non-Rice Livelihood	DAR	RA6657, MOA	ARF
30. Livelihood Financing (SLFAP)	Congress/LBP	MOA	CDF/ NGOs
31. Earthquake Rehabilitation (ERP)	DA-SCO/PMO	Loan Agreement	
<i>Poor (7)</i>			
32. Micro Credit for the Bottom Poor			Special fund
33. Coop Dev't Loan Fund (CDLF)	DA-ACPC	EO/ RA	Budget; foreign loan/grant
34. Coop Rehab & Dev't Loan (CRDLF)	CDA	RA 6938 / RA 6939	Budgetary allocation
35. Tulay 2000	CDA	RA 6939	Budgetary allocation
36. Tulong sa Tao for Poor (TST-CPPP)	DOLE-BLE	RA 7277	Special Fund
37. TST-NGO-MCP II	DTI	RA 5416	Foreign Grant
38. TST- SubCon	DTI	MOA / EO	Budget; foreign loan/grant
	DTI	MOA/ EO	
<i>Salaried & Self-Employed (3)</i>			
39. Workers Entrepreneurship Program	DOLE-BLE	Department Order	Budgetary allocation
40. Tulay 2000			
41. OWWA			
II. Government Financial Institutions (GFIs)			
<i>Small and Medium Enterprises (13)</i>			
42. Cottage Enterprise Finance (CEFP)	DBP	MOA	Foreign loan
43. Damayan sa Pamumuhunan (DPP)	DBP		CDF
44. Shipping Modernization (DSMP)	DBP	MOA	Foreign loan
45. Environmental Infrastructure (EISCP)	DBP		Foreign loan
46. Industrial Guarantee & Loan (IGLF)	DBP	MOA	Foreign loan
47. Industrial-Investment Credit (IICP)	DBP	MOA	Foreign loan
48. Industrial Re-structuring (IRP)	DBP	Loan Agreement	Foreign loan
49. Industrial & Support Services (ISSEP)	DBP	Loan Agreement	Foreign loan
50. AJDF-JEXIM I	DBP	Loan Agreement	Foreign loan
51. AJDF-JEXIM II	DBP	Loan Agreement	Foreign loan
52. AJDF-JEXIM III	DBP	Loan Agreement	Foreign loan
53. OECF	DBP	MOA	Foreign loan
54. OCEF-MCDP III	LBP	Loan Agreement	Foreign loan
<i>Poor (2)</i>			
55. Special Livelihood Financing (SLFAP)	LBP	MOA	CDF, NGOs
56. Rural Farmers & Agra Ref. (RASCP)	LBP	Loan Agreement	OECF

Table I cont.

Programs / Sector	Implementing Agency	Legal Basis	Fund Source
<i>Salaried & Self-Employed (1)</i> 57. Kawal Pilipino (KPK) 2000	LBP	MOA	AFP-RSBS
III. Government Owned & Controlled Corporations (GOCC) Institutions (NBFI)			
<i>Small and Medium Enterprises (6)</i> 58. Direct Micro Lending (SDML) 59. Small Ent. Financing (SEFF) 60. Rediscounting (RDF-SE) 61. Coop Marketing (CMP) 62. Coop Support Fund (CSF) 63. CDF/CIA	TLRC SBGFC SBGFC CDA CDA CDA	RA 6938 / RA 6939 RA 6939 RA 6939	Corporate Funds SBGFC Funds SBGFC Funds
<i>Agriculture (17)</i> 64. Farm Grains Center (FLGC) 65. Gintong Ani-Coop Credit (GA-CCAP) 66. GA-Federations/PO (GA-FPO) 67. GA-AgriBusiness (GA-JAV) 68. GA-Credit Guarantee (GA-CGP) 69. Poverty Allev. for Farmers (PAF-DAF) 70. GA-Crops (GA-LGC) 71. Livelihood for Fisherfolk (ILPF) 72. GA-LGU 73. Agri Marketing & Prod'n (CAMP) 74. DAPCOPO 75. Food & Agri Retail (FARE) 76. Farm Grains Center (FLGC I) 77. Agri Prog for Rebel Returnees 78. Livelihood Assis. For ARCs (LCAP) 79. Livelihood Ass. Outside ARCs 80. Agro Industrial Tech Transfer (AITTP)	NAFC QuedanCor QuedanCor QuedanCor QuedanCor QuedanCor QuedanCor QuedanCor QuedanCor QuedanCor QuedanCor QuedanCor NFA NRDC NLSF NLSF TLRC	RA 7393, MOA RA 7393, MOA RA 7393, MOA RA 7393, MOA RA 7393, MOA RA 7393, MOA RA 7393, MOA RA 7393, MOA RA 7393, MOA RA 7393, MOA RA 7393, MOA RA 7393, MOA RA 7393, MOA MOA EO715, AO75, RA6657 EO715, AO75, RA6657 Loan Agree., PD 1097	RP-Japan Food Production CALF Budgetary allocation Budgetary allocation Budgetary allocation DA-SRC Budgetary allocation DA-BFAR Budgetary allocation Corporate funds DAPCOPO, CALF Corporate Funds Budgetary allocation Budgetary allocation Budgetary allocation OEFC
<i>Poor (2)</i> 81. HIRAM 82. ADB-IFAD Rural Microenterprise	PCFC PCFC	MOA Project Agreement	NLSF Internal Funds ADB-IFAD

Source: Directed Credit Programs in the Philippines: The Experience and Policy Reform Issues, Volumes I and II, CPIP WP# 1.
Assessment of the Performance of GNFA's in Implementing Directed Credit Programs, WP #5.
Assessment of the Performance of GFIs and GOCCs/NBFIs in Implementing Directed Credit Programs, WP# 10.

Executive Order 138

E.O. 138 spells out the basic policies to guide the implementation of government credit programs. It directs all government entities involved in the implementation of credit programs to adopt the credit policy guidelines formulated by the NCC. In turn, the NCC is directed to formulate the operating guidelines of the E.O. built on the following four principles:

- Greater role of the private sector in the provision of financial services to the basic sector;
- Adoption of market-oriented financial and credit policies, e.g., market-oriented interest rates on loans and deposits;
- Government to provide an enabling policy environment, critical support services and capability-building services that will facilitate the increased participation of the private sector in the delivery of credit services;
- Non-participation of government non-financial agencies (GNFAs) and government-owned and -controlled corporations (GOCCs) in the implementation of credit programs.

In line with these principles, the E.O. directs GNFAs and GOCCs to immediately rationalize, in accordance with NCC guidelines, all directed credit programs they are implementing. The remaining funds of those credit programs will be channeled through government financial institutions (GFIs) such as the Land Bank and DBP to end borrowers through private financial institutions.

Henceforth, GNFAs and GOCCs will focus on providing the necessary infrastructure support such as farm to market roads, irrigation services, education and training, and information dissemination. GFIs, on the other hand, will primarily be wholesalers of credit funds to private financial

institutions. The latter include not only banks but also cooperatives, non-government organizations and other microfinance institutions. GFIs may go into retail lending only for sectors not adequately served by private financial institutions.

The E.O. clearly states that government credit programs should charge “not lower than the prevailing market rates”. At a minimum, this means that interest rates charged should cover the financial and operational costs of implementing institutions. This will not only ensure sustainability of the credit programs and promote greater outreach but also instill financial discipline and responsibility among its borrowers and clientele.

Similarly, external funding for credit programs will be allowed only if they conform to NCC guidelines and do not distort the financial market either by granting loans at subsidized interest rates or by fostering an environment where credit conduits become reliant on these sources of financing and neglect savings mobilization.

E.O. 138 and the AFMA

Republic Act 8435 (1997) or the Agriculture and Fisheries Modernization Act (AFMA) provided the initial impetus for the rationalization of government directed credit programs. The AFMA directs the Department of Agriculture to, within four years, phase-out directed credit programs in the agriculture sector and to transfer all loan funds to a facility called the Agro-Industry Modernization Credit and Financing Program (AMCFP).

Just like E.O. 138, the AFMA spells out the government's basic credit policy in terms of market-oriented interest rates and encouraging private sector participation in rural financial markets. E.O. 138 and the AFMA are, thus, complementary measures to implement the government's rationalization program for directed credit programs.

The AFMA phases out directed credit programs in the agriculture sector while E.O. 138 phases out directed credit programs in other sectors as well.

With both in place, the government hopes to avoid the recurrence of what happened in 1986, when, even as credit programs in the agriculture sector were being rationalized, directed credit programs in other sectors proliferated. Rationalizing directed credit programs in all sectors would level the playing field, avoid duplication/overlapping, eliminate unfair competition with the private sector and allow the market to allocate resources to their most efficient uses.

Fiscal Implications of the E.O.

By getting GNFA's out of implementing directed credit programs and by calling for the adoption of market-oriented interest rates, E.O. 138 will allow more efficient use of scarce fiscal resources and minimize distortions in the financial market. In particular:

- a) Government savings will be realized since subsequent budgetary allocation for government line agencies for the implementation of subsidized credit programs will be discontinued as soon as the phase out begins. A Credit Policy Improvement Program (CPIP) survey reports that initial fund allocation for 63 programs amounted to P40 billion in 1996, or 1.8% of GNP. Of this amount, P2 billion were sourced from the national budget to finance 25 programs. The bulk, or P34 billion, came from foreign loans, which carried government guarantees and are thus, a source of contingent liabilities for the national government.
- b) There will be more government resources for infrastructure and capability building services. With the implementation of E.O. 138, resources that used to be earmarked for subsidized credit

programs can now be used to fund infrastructure support and capability building services. Studies show that provision of these services has a large multiplier effect, especially in the countryside.

- c) The distortionary effect of government credit subsidy on the financial market will be eliminated. CPIP studies show that the majority of the current crop of directed credit programs are not efficiently implemented and thus, are not sustainable. Aside from non-repayment of loans (average repayment rate of 70% to 80%), interest rates charged by the programs are usually below market rates for similar loan contracts and are not sufficient to cover the costs of the program. Failure of the borrower to repay all or part of his loan results in default subsidies. Similarly, charging of interest rates that are below market also results in interest subsidies. The CPIP study estimated interest and default subsidies at P1.9 billion for 20 programs in 1996 alone. Interest subsidies totaled P1.4 billion while default subsidies summed to P510 million.

Conclusion

The NCC in consultation with concerned government agencies shall formulate the operating guidelines and spell out the parameters for rationalizing existing directed credit programs. Table I shows that the programs have different legal bases, which make some easier to terminate than the others. Among the former are programs created through Department Orders, Administrative Orders and Executive Orders. Among the latter are programs created under Republic Acts (which require legislative action to repeal) and those backed by bilateral loan agreements between the Philippines and the donor country (which needs to be reviewed and amended if necessary). A timetable for rationalizing each program must be drawn up.

Effective management of activities during the phase-out period is critical. It is crucial that as the directed credit programs are being phased out, microentrepreneurs and other small scale borrowers have alternative sources of funds for their productive activities. Here, the lending windows of the Land Bank, the DBP and the People's Credit and Finance Corporation (PCFC), which will continue operating, will gain significance.

Finally, it is important to remember that E.O. 138 and the AFMA are not calling for an end of government support to microentrepreneurs, farmers, fisherfolks and other sectors. Rather, both

E.O. 138 and the AFMA will result in more efficient use of government financial resources and greater focus on small scale borrowers and the basic sectors. Elimination of overlapping and duplicative credit programs, on the one hand, and the use of rural banks, credit cooperatives and viable credit NGOs on the other, will give more opportunity to the basic sector to access financial services.

At the same time, by making line agencies focus on their respective mandate, e.g., providing rural roads, the government will be creating the necessary condition and environment for viable financial markets. □

Rationale for E.O. 138

- *The government puts priority on the alleviation of poverty in the country;*
- *Greater access to financial services is considered one of the important components in improving the living conditions of the disadvantaged sectors of the economy;*
- *There are at least 82 government-funded credit programs that are inefficiently managed and implemented, resulting in huge inefficiencies and waste of scarce government resources;*
- *The basic sector still lacks access to credit services despite the proliferation of several directed credit programs implemented by government line agencies;*
- *In 1994, Administrative Order No. 86 mandated the National Credit Council (NCC) to rationalize directed credit programs with the government providing a supportive and appropriate policy environment and institutional framework towards a viable and sustainable financial market;*
- *The government will continue to pursue a liberalized and market-oriented economy where the private sector plays a major role and the government provides the enabling environment for the efficient functioning of markets and the participation of the private sector. This policy is explicitly espoused in the recently enacted Agriculture and Fisheries Modernization Act and the Social Reform and Poverty Alleviation Act; and*
- *Under this policy, subsidies provided by the government will be transparent to encourage the private sector to provide financial services to the basic sector. The government will, likewise provide welfare assistance, instead of credit, to the most disadvantaged sector of the economy.*

List of NCC Policy Notes:

- | | |
|---|--|
| <ul style="list-style-type: none"> • <i>National Strategy for Microfinance</i> • No. 98-01:
<i>Regulatory Barriers to Innovative Lending Practices: Traditional Approaches to Bank Supervision</i> • No. 98-02:
<i>Assessment of the Role and Performance of Government Non-Financial Agencies in Implementing Directed Credit Programs</i> • No. 98-03:
<i>Interest Rates, Subsidies, and Directed Credit Programs in the Philippines</i> • No. 98-04:
<i>Impact of Mandated Credit Programs on Financial Institutions</i> • No. 98-05:
<i>Microfinancing for the Poor: Experiences of Government Non-Bank Agencies</i> | <ul style="list-style-type: none"> • No. 98-06:
<i>Assessment of the Performance of GFIs and GOCCs/NBFI in Implementing Directed Credit Programs</i> • No. 98-07:
<i>Microlending After the Asian Financial Crisis</i> • No. 98-08: <i>Loan Guarantee Programs in the Philippines: The Dilemma of Sustainability and Outreach</i> • No. 99-01:
<i>Deposit-taking Cooperatives: Time to Talk Regulation</i> • No. 99-02:
<i>Policy Framework for Rationalizing Directed Credit Programs</i> • No. 99-03:
<i>The Agro-Industry Modernization Credit and Financing Program: An Alternative to Directed Credit Programs in Agriculture</i> |
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For further information, please contact

National Credit Council Secretariat Department of Finance

Assistant Secretary Gil S. Beltran
Ma. Teresa S. Habitan
Joselito S. Almario
Ma. Lourdes V. Dedal
Aurora Luz D. Villaviray
Febe J. Lim
Eric Tipgos

4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287

Credit Policy Improvement Program Project Management Office

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo

4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph



National Credit Council

Policy Notes

NOVEMBER 1999

NO. 99-05

Transforming The Cooperative Development Authority

Introduction

AS OF THE LATEST COUNT, there are more than 50,000 cooperatives registered with the Cooperative Development Authority (CDA). The exact health and operating status of these cooperatives are not known. A survey made by the CDA of 45,668 cooperatives in 1997 found that 12,751 or 28% were not operating. These non-operating cooperatives have not been delisted and remain in the CDA's registry to this day.

On the other hand, a recent Credit Policy Improvement Program (CPIP) study of the operating cooperatives, revealed that in 1997, only 11,344 submitted the required annual report while a smaller subset of 10,088 cooperatives submitted audited financial statements.¹ Both documents are requirements of the CDA for registered cooperatives to continue operating. However, to date, the CDA has yet to cancel the certificate of registration of non-compliant cooperatives.

These figures plainly show what one can expect of CDA's regulation of cooperatives. Without the requisite information about membership, nature of operations, financial standing, etc., regulation is impossible to carry

out. In the same manner, without vesting CDA with supervisory powers, to allow it to check submitted information for accuracy, regulation cannot proceed effectively.

Much of the CDA's weaknesses can be traced to Republic Act 6939 or the CDA Act itself. The Act vests the CDA with a dual role — developmental and regulatory. In line with its developmental function, the CDA strives to increase the number of registered cooperatives in the country. However, it has done this at the expense of higher quality registrants as applications are always approved. Worse still, the CDA administers the legislator's Congressional Initiative Allocation (CIA) and Countrywide Development Fund (CDF), which are used to provide subsidized credit to cooperatives. This has led to the establishment of many "fly-by-night" cooperatives, created purely as conduits for the credit funds. These cooperatives fold up once credit funds dry up.

On the other hand, the CDA's regulatory role is limited to registering cooperatives. While it has the power to cancel a cooperative's

¹ Lee Arbuckle, Rescy Bhagwani, Gilberto M. Llanto, Ma. Piedad S. Geron and Ronald Zeno Abenoja, "Review of the Regulatory Environment for Deposit-taking Cooperatives," CPIP, 1998.

certificate of registration as well as merge, consolidate, dissolve and liquidate cooperatives, it hesitates to do so because of the principle of subsidiarity in the Cooperative Code (Republic Act 6939). The principle of subsidiarity essentially recognizes that cooperatives are organized by the private sector and that the cooperative sector will regulate itself. Hence, the CDA has opted to take an arms-length approach towards regulating cooperatives, focusing instead on discharging its developmental role while giving a sound registry and regulation minor attention.

The CDA's inability to carry out its regulatory function effectively is worrisome because it is mostly the poor people who put in their money in the more than 50,000 registered co-ops. It is also especially worrisome because at least 11,143 of the registered cooperatives are either credit cooperatives or multipurpose cooperatives with deposit-taking functions. Because of their financial intermediary function and because many deposit-taking cooperatives have a broad membership base, their failure may

cause serious economic displacement in a particular community. Hence, it is important that the CDA exercise effective regulation and supervision over these cooperatives.

House Bills to Strengthen the CDA

Recognizing the limitations of Republic Act 6939, two bills have recently been drafted in Congress to address the CDA's weaknesses (See Table for Comparative Features). The Cooperative Regulatory and Development Authority (CRDA) Bill, authored by Congressman Cresente C. Paez, seeks to strengthen the regulatory powers of the CDA, re-orient its developmental functions, and vest it with supervisory and adjudicative functions. Similarly, House Bill (HB) 8258, authored by Congressman Salacnib F. Bateria, aims to strengthen the CDA's regulatory powers and provide it with quasi-judicial functions. But unlike the CRDA Bill, HB 8258 retains all of CDA's developmental functions and even included additional developmental powers.

Comparative Features of CDA Act and House Bills

Powers/Functions/Responsibilities	CDA Act	CRDA Bill	HB 8258
Developmental Functions			
1. Planning	✓	✓	✓
2. Coordinating	✓	✓	✓
3. Supporting Co-ops	✓	✓	✓
4. Policy-making	✓	✓	✓
5. Organizing Co-ops	✓	X	✓
6. Education/Training	✓	X	✓
7. Financing/Lending	✓	X	✓
8. Conduct researches/studies	X	X	✓
9. Monitor/evaluate training & educ. prog.	X	X	✓

Comparative (cont.)

Powers/Functions/Responsibilities	CDA Act	CRDA Bill	HB 8258
Regulatory/Supervisory			
10. Register	✓	✓	✓
11. Require F/S & other reports	✓	✓	✓
12. Order cancellation	✓	✓	✓
13. Mediate and conciliate	✓	✓	✓
14. Issuance of Certificate of Good Standing	X	✓	X
15. Prescribe accounting standards	X	✓	X
16. Examination	X	✓	X
Adjudicating			
17. Issue injunctions	X	✓	✓
18. Appoint receivers	X	✓	✓
19. Cite persons/entities in contempt	X	✓	✓
20. Issue subpoenas	X	✓	✓
21. Compel officers to call meetings of general assembly or Board of Directors	X	✓	✓
22. Create management committee	X	✓	✓
23. Impose fines and penalties	X	✓	✓
24. Investigate co-op directors and members	X	✓	✓
25. Conduct management or financial audit	X	X	✓

✓ Provided X Not provided

Overall, HB 8258 builds on existing functions of the CDA and gives it additional powers in the belief that these extra powers will make the CDA a more effective developmental and regulatory body. The CRDA Bill, on the other hand, recognizes the inconsistency between the CDA's developmental and regulatory functions and thus, aims to de-emphasize the former while strengthening the latter. The CRDA Bill re-orientes the CDA's developmental functions based on the principle of subsidiarity, i.e., cooperatives are largely left to organize and develop themselves, with the

proposed CRDA playing a mere supporting role. Thus, the proposed CRDA will "work with and through the cooperative sector..... in the performance of its remaining developmental functions." In line with the proposed CRDA's reduced developmental activities, the CRDA Bill directs that all loanable funds still under the CDA be deposited in a trust account at the Land Bank. The funds will later be transferred to a National Savings and Credit Cooperative or a Cooperative Deposit Insurance System which will be organized. Hence, the proposed CRDA will no longer lend to cooperatives.

In contrast to their differences in promoting CDA's developmental functions, both House Bills vest the CDA (or the proposed CRDA) with adjudicative functions and give it quasi-judicial powers a la Securities and Exchange Commission. Among the cases which the CDA will have exclusive jurisdiction over are: (a) fraud and misrepresentation by directors, officers and members of cooperatives; (b) petitions of cooperatives to be declared in a state of suspension of payments of debts; (c) violations of the provisions of the proposed CRDA Act and the Cooperative Code; and (d) controversies concerning a cooperative's legal right to exist. The CRDA Bill likewise spells out the means of settling disputes with the CRDA's jurisdiction limited only to cases which the internal mediation and conciliation mechanism of the cooperative or the apex organization is not capable of resolving.

In terms of regulation and supervision, the CRDA Bill seems superior to HB 8258 as it mandates the proposed CRDA to develop and prescribe a system of accounting and performance standards and explicitly gives the proposed CRDA examination powers to look into the books and records of the cooperatives. It also requires all cooperatives registered with the CDA to regularly submit their annual report and audited financial statements to the proposed CRDA for them to enjoy tax. With these, the proposed CRDA is well equipped to weed out weak cooperatives, ensuring a healthy and sound cooperative sector. While HB 8258 likewise provides the CDA the power to conduct financial or management audit, it does so in the context of the CDA's adjudicative function and not as part and parcel of the regulation and supervision process.

As well, the CRDA Bill provides for a more transparent election of the proposed CRDA's Board of Directors, with nominees to the Board

chosen through a representative assembly of national federations and unions. HB 8258, on the other hand, largely preserves the electoral process of the present CDA.

The CRDA Bill

On the whole, the CRDA Bill is the more promising of the two House Bills in terms of making the CDA a more effective regulatory body. The CRDA Bill seeks to strengthen the CDA's regulation over cooperatives not by simply giving it additional powers but by restructuring the Authority and eliminating conflicting roles. The CRDA Bill addresses many of the problems (as highlighted in the CPIP study on the regulatory environment for cooperatives) that hinder the CDA from effectively carrying out its regulatory functions. Among these are:

1. There is a dearth of quality and consistent up-to-date information on cooperatives within the CDA. Without accurate and reliable data, there is no way to measure the success of the cooperative sector. The CRDA Bill addresses this concern by mandating the proposed CRDA to develop and prescribe a set of accounting standards for different types of cooperatives. These standards are especially important for credit cooperatives due to their fiduciary functions. Likewise, multipurpose cooperatives will benefit by allowing them to segregate records for financial intermediation from other activities, thus, pinpointing which activities are income-generating and which are prone to losses.
2. The CDA has a "permissive" attitude towards cooperative registration. It reported a number of non-operating cooperatives still in the CDA's registry but it has not taken any step to delist them. Consistent with this,

the CRDA bill provides that cooperatives, in order to continue enjoying tax exemption, have to, among others, regularly submit their annual report and audited financial statement. With this, the proposed CRDA can, within one year, establish an accurate registry of operating cooperatives and make the Certificate of Registration a more meaningful document.

3. Government directed credit programs are the “poison pill” of credit cooperatives because (a) cooperatives end up neglecting savings mobilization; (b) borrowers tend to perceive government funds as “dole-outs” which need not be repaid; and (c) many cooperatives set up for the sole purpose of receiving these subsidized credit disband once the loans are fully disbursed. Recognizing this, the CRDA Bill rids the CDA of its direct lending function. The Bill directs the CDA to transfer remaining loanable funds to the LBP.
4. The current CDA Act does not explicitly mandate the CDA to inspect cooperatives. It reports that while the CDA conducts examinations of cooperatives’ financial records, it does so only cursorily and is not concerned with proper and accurate booking of transactions. The CRDA Bill corrects this flaw by explicitly vesting the proposed CRDA with examination powers to look into cooperatives’ financial records. This way, the proposed CRDA can also validate the submissions of the cooperatives. In addition, the proposed CRDA is given the authority to suspend, cancel the registration, censure or impose limitations on the activities of any cooperatives.
5. The CDA is able to issue rules and regulations to implement the provisions of the law. However, the law does not explicitly

clothe it with enforcement powers. In the one instance that it does (cancellation of registration for non-submission of reports and violation of laws), CDA enforcement has been lenient. In contrast, the CRDA Bill vests the proposed CRDA the authority to carry out its adjudicative functions. These quasi-judicial powers give the proposed CRDA teeth in implementing the rules and regulations that it imposes.

Markets and Regulation

Markets are increasingly becoming integrated and governments are striving for market-oriented policies and private sector-led financial markets. How then does the CRDA Bill, which calls for strengthened government regulation of the cooperative sector, fit in?

The answer lies in understanding that regulation and market orientation are not mutually exclusive or inconsistent. In any aspect of economic management, the role of the government is to make sure that markets work and that failures of the market are corrected. In certain cases, this can be achieved either by removing market-distorting rules or by imposing regulations that “level the playing field.” Thus, a deregulated environment need not mean the absence of regulation. Rather, what is needed in such an environment is a regulatory framework that does not constrain the market from doing its tasks.

Put differently, what is required is a regulatory framework that re-enforces and promotes the efficiency of markets.

As it currently stands, the cooperative sector is largely unregulated with practically no barriers to entry. This free state has spawned the establishment of a number of cooperatives that have relied on external aid and subsidized

credit and have folded up once funds dried up. Because many cooperatives mobilize savings from the community, their failure is of concern to the public and government, especially since such failure may cause serious economic dislocation in a particular community.

On the other hand, there are also strong cooperatives organized by private individuals that have managed to grow without a single centavo from the government. They also take deposits from thousands of members. This situation also gives rise to problems of prudential regulation.

Hence, it is important that government regulation over cooperatives be strengthened, especially in the case of deposit-taking cooperatives. Here lies, the timeliness of the proposed CRDA bill.

List of 1999 NCC Policy Notes:

- **No. 99-01:**
Deposit-taking Cooperatives: Time to Talk Regulation
- **No. 99-02:**
Policy Framework for Rationalizing Directed Credit Programs
- **No. 99-03:**
The Agro-Industry Modernization Credit and Financing Program: An Alternative to Directed Credit Programs in Agriculture
- **No. 99-04:**
Executive Order 138: Towards Sustainable Financial and Credit Policies

For further information, please contact

National Credit Council Secretariat Department of Finance

Gil S. Beltran
Ma. Teresa S. Habitan
Joselito S. Almario
Ma. Lourdes V. Dedal
Aurora Luz D. Villaviray
Febe J. Lim
Eric C. Tipgoss

*4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 523-3825 and 525-3305
Fax No: 524-4287*

Credit Policy Improvement Program Project Management Office

Gilberto M. Llanto, Ph.D
Ma. Piedad S. Geron, Ph.D
Susan R. Elizondo
Mary Ann D. Rodolfo

*4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Malate, Manila
Telephone No: 525-0487
Telefax No: 525-0497
E-mail: cpipuser@philonline.com.ph*

National Strategy *for* Microfinance

The Problem

One of the major socio-economic problems besetting the Philippine economy is the pervasiveness of poverty. Based on the 1994 Family Income and Expenditure Survey (FIES), there are about 4.7 million poor Filipino households. This translates into a poverty incidence of 35.7 percent, with rural poverty incidence (53.7 percent) significantly higher than urban poverty incidence (28.8 percent).

A good number of poor households below the poverty line are engaged in microenterprises. A perennial problem of these microentrepreneurs is the lack of access to financial services. The latest NEDA survey indicated that less than 12 percent of low-income rural families borrowed since 1991. Of these, nearly two-fifths sourced their loans from relatives and friends while another one-third borrowed from private moneylenders and cooperatives. Only a small percentage relied on banks (government or private) for loans.

Because of information problems, inadequate collateral and the high transaction costs associated with processing small loans, private banks rarely, if at all, lend to microentrepreneurs. The borrowers themselves do not approach the banks due to burdensome requirements, high interest rates, lack of collateral and lack of information on possible sources of financing. As a result, the microenterprise credit market consists mostly of credit cooperatives, credit unions, some rural banks, and a handful of credit NGOs. Government agencies implementing various loan programs are also present.

In general, these microfinance institutions (MFIs) have limited outreach. Among MFIs, cooperative banks and

credit cooperatives have the widest estimated outreach. Recent field observations show that these two groups, together with rural banks and credit unions, have the network necessary to provide microfinance on a national scale.

Attempts to Address the Problem

One of the government's strategies to alleviate poverty is to provide poor households engaged in microenterprise activities access to production and consumption-smoothing credit. Hence, in the 1970s and 1980s, the government created a number of directed credit and guarantee programs, especially in the agriculture sector. Some common features of these programs are:

- (a) funding came from government budgetary appropriations, the Central Bank's rediscounting window and foreign borrowings;
- (b) funds were provided through specialized banks (e.g., rural banks, development banks, and government financial institutions) for direct avancement by the targeted borrowers; and
- (c) funds were given at highly concessional rates.

These programs provided massive credit subsidies to bring down the cost of borrowing for the targeted sectors. But instead of benefiting small borrowers, the eventual credit rationing and high loan defaults enabled large-scale borrowers to capture the subsidies. Moreover, due to the availability of cheap loan funds, deposit mobilization was neglected leading ultimately to the weakening of rural banks.

These experiences, coupled with the fiscal costs of the programs, led the government to pursue financial

market reforms in the mid-1980s. These reforms included:

- (a) adoption of market oriented interest rates;
- (b) termination of subsidized rediscounting programs at the Central Bank;
- (c) consolidation of existing agricultural credit programs into the Comprehensive Agricultural Loan Fund (CALF) which served as a loan guarantee fund for agricultural loans granted by banks; and
- (d) termination of direct lending by government agencies implementing agricultural credit programs.

While these reforms were introduced and implemented in the agriculture sector, there was a proliferation of programs in other sectors. Subsidized credit programs for small and medium-scale enterprises as well as for livelihood projects multiplied. Many of these were implemented through government agencies. At the same time, laws were passed mandating loan quotas for targeted sectors. These include the Agri-Agra Law (PD 717), the Magna Carta for Small and Medium Enterprises (RA6977) and the Magna Carta for Small Farmers.

With the Ramos administration came increased emphasis on private sector participation. The 1991-1998 Medium Term Philippine Development Plan articulated the government's twin strategies of global competitiveness and people empowerment. In the financial sector, these meant the implementation of market-based financial and credit policies and the increased participation of the private sector in the marketplace. The government will only play an enabling and strategic role through the provision of an appropriate policy environment for markets to function efficiently. Government financial institutions, on the other hand, will be re-oriented toward supplementing the private sector's initiative in providing financial services to microentrepreneurs.

Even as the government pursued reforms to enhance market efficiency, it adopted the Social Reform Agenda (SRA) to address the poverty problem in the

country. Among others, the SRA's action agenda include providing the poor access to economic opportunities within a liberalized and deregulated market. This has encouraged a number of financial (rural banks, cooperatives, etc.) and non-financial (credit NGOs) institutions to engage in innovative lending techniques to address the credit demand of microentrepreneurs. However, despite the avowed market orientation of financial and credit policies, there is still pressure from various interest groups for government to provide credit subsidies and create more directed credit programs.

The result is a basic inconsistency between microfinance policies and credit programs intended to support those policies. The policy-program inconsistency creates a flawed incentive structure that encourages various players in the microfinance market to pressure government for more credit subsidies, loan quotas and other distortionary measures. The end product is a microfinance market that appears more constrained in providing the target clientele access to financial services.

The Vision and the Objective

The vision is to have a **viable and sustainable private (micro) financial market**. This will be achieved in a liberalized and market oriented economy where the private sector plays the major role and the government provides the enabling environment (through the appropriate policy and institutional framework) for the efficient functioning of markets.

Specifically, the objective is to provide low income households and microenterprises access to financial services. The target group consists of those who live below the poverty line and are engaged in some form of business or economic activity, but who do not have access to or are inadequately served by the formal financial sector.

Realizing the Objective

The Policy Framework

In accordance with the vision, private microfinance

institutions (MFIs) will provide microentrepreneurs financing services on a viable and sustainable basis while the government will provide a competitive and liberalized market environment. The government's microfinance policy is built on the following principles:

- greater role of the private sector (MFIs) in the provision of financial services;
- an enabling policy environment that will facilitate the increased participation of the private sector in microfinance;
- market-oriented financial and credit policies, e.g., market-oriented interest rates on loan and deposits;
- non-participation of government line agencies in the implementation of credit and guarantee programs.

Hence, the government will avoid costly, unsustainable and distorting credit subsidies that, in the past, failed to reach their intended beneficiaries, led to the weakening of the rural banking system, and saddled the government with a huge fiscal burden. Instead, emphasis will be placed on financial intermediation to ensure the efficient channeling of surplus financial resources to viable projects. A conscious effort will, therefore, be made to promote savings mobilization by MFIs.

Moreover, credit policy will be distinguished from welfare policy. Welfare assistance will be provided to address the needs of the really poor households through the appropriate government departments. Welfare will not be extended through concessional credit, loan quotas and other financially repressive measures and never through financial institutions, whether government or private.

Credit demand of microentrepreneurs, on the other hand, will be met through a variety of innovative financial products provided by the private microfinance market. The government will assist in capacity building of MFIs and in providing the appropriate supervisory and regulatory framework to make markets more efficient and institutions more viable.

The Institutional Framework

Given the policy framework, the respective roles of the various players in microfinance, based on their relative comparative advantages, are:

- **Microfinance Institutions (MFIs):** to engage in sound, sustainable and viable microfinance intermediation;
- **National Government through the National Credit Council (NCC):** to provide a market-oriented financial and credit policy environment which will promote efficient financial markets and will help private MFIs broaden and deepen their microfinance services;
- **People's Credit and Finance Corporation (PCFC):** to provide wholesale funds and technical assistance to MFIs; to support the development of innovative financial products and services for microentrepreneurs;
- **Commercial and other private banks:** to provide wholesale funds and financial services to MFIs;
- **Government financial institutions:** to provide wholesale funds (including those sourced from foreign borrowings) to MFIs that do not have access to funds from private commercial banks;
- **NGOs:** to facilitate linkages between micro-entrepreneurs on one end and MFIs and community organizations on the other end; to assist in capacity building of target clientele;
- **Donors:** to provide assistance for social preparation activities and other activities that will broaden and deepen microfinance services (e.g., development of microfinance products, training in microfinance technologies, and upgrading of performance standards, operating systems and procedures); to assist in areas that have been identified through a consultative process between the NCC and MFIs.

The Strategies to be pursued

The following strategies, aimed at providing

microentrepreneurs greater access to microfinance services, will be pursued:

- a. Provision of a financial and credit policy environment that is conducive to the effective and efficient functioning of the financial market. This will be done by:
- Implementing a market-oriented interest rate policy
 - Pursuing financial policy reforms with the end in view of removing existing distortions in the financial market (e.g., loan quotas, earmarking of public funds for direct lending, etc.)
 - Rationalizing all existing government credit and guarantee programs towards encouraging greater private sector participation in a market-oriented setting
- b. Establishment of a market-oriented financial and credit policy environment which is conducive to the broadening (development of new product lines and services, implementation of new microfinance technologies and practices) and deepening (increased microfinance intermediation) of microfinance services. This will be accomplished by:
- Providing the appropriate supervisory and regulatory framework for MFIs that will enable them to develop new and innovative product lines and services to cater to the demands of poor households and microenterprises;

- establishing standards of performance and business practices to guide the operations of MFIs;
 - promoting broad-based savings mobilization, linking banking technology with microfinance technologies;
 - providing information and training to MFIs on best practices in microfinance.
- c. Implementation of a capacity-building program for MFIs. This will be implemented by:
- providing technical assistance to MFIs, stressing (1) local deposit mobilization, (2) financial and project management, (3) use of information technology, (4) development and establishment of microfinance technology, innovative product/service lines.
 - documenting, packaging and disseminating practitioner-based training and technical services to MFIs, through the PCFC.
 - encouraging research and academic institutions to conduct studies and convene policy level discussions that will promote awareness of microfinance as a sound commercial investment. These institutions will identify best practices in microfinance, develop and install training and microfinance technology packages.

For further information, please contact

**The National Credit Council (NCC) Secretarial
Department of Finance**

4th Floor Executive Tower Building
Bangko Sentral ng Pilipinas Complex
Roxas Boulevard, Manila
Telephone Nos: 525-3305 and 524-4287
Fax No: 525-3305
E-mail: gill@dof.gov.ph and auroraluz@hotmail.com

REPUBLIC ACT NO. 8425
AN ACT INSTITUTIONALIZING THE SOCIAL REFORM AND POVERTY
ALLEVIATION PROGRAM, CREATING FOR THE PURPOSE THE
NATIONAL ANTI-POVERTY COMMISSION, DEFINING ITS POWERS AND
FUNCTIONS, AND FOR OTHER PURPOSES

SECTION 1. *Title.* — This Act shall be known as the "*Social Reform and Poverty Alleviation Act.*"

SECTION 2. *Declaration of policy.* — It is the policy of the State to:

(1) Adopt an area-based, sectoral and focused intervention to poverty alleviation wherein every poor Filipino family shall be empowered to meet its minimum basic needs of health, food and nutrition, water and environmental sanitation, income security, shelter and decent housing, peace and order, education and functional literacy, participation in governance, and family care and psycho-social integrity;

(2) Actively pursue asset reform or redistribution of productive economic resources to the basic sectors including the adoption of a system of public spending which is targeted towards the poor;

(3) Institutionalize and enhance the Social Reform Agenda, hereinafter known as the SRA, which embodies the results of the series of consultations and summits on poverty alleviation;

(4) Adopt and operationalize the following principles and strategies as constituting the national framework integrating various structural reforms and anti-poverty initiatives:

(a) Social reform shall be a continuing process that addresses the basic inequities in Philippine society through a systematic package of social interventions;

(b) The SRA shall be enhanced by government in equal partnership with the different basic sectors through appropriate and meaningful consultations and participation in governance;

(c) Policy, programs and resource commitments from both government and the basic sectors shall be clearly defined to ensure accountability and transparency in the implementation of the Social Reform Agenda;

(d) A policy environment conducive to sustainable social reform shall be pursued;

(e) The SRA shall address the fight against poverty through a multi-dimensional and cross-sectoral approach which recognizes and respects the core values, cultural integrity, and spiritual diversity of target sectors and communities;

(f) The SRA shall pursue a gender-responsive approach to fight poverty;

(g) The SRA shall promote ecological balance in the different ecosystems, in a way that gives the basic sectors a major stake in the use, management, conservation and protection of productive resources;

(h) The SRA shall take into account the principle and interrelationship of population and development in the planning and implementation of social reform programs thereby promoting self-help and self-reliance; and

(i) The SRA implementation shall be focused on specific target areas and basic sectors.

SECTION 3. *Definition of terms.* — As used in this Act, the following terms shall mean:

(a) *"Artisanal fisherfolk"* — Refers to municipal, small scale or subsistence fishermen who use fishing gear which do not require boats or which only require boats below three (3) tons;

(b) *"Basic sectors"* — Refer to the disadvantaged sectors of Philippine society, namely: farmer-peasant, artisanal fisherfolk, workers in the formal sector and migrant workers, workers in the informal sector, indigenous peoples and cultural communities, women, differently-abled persons, senior citizens, victims of calamities and disasters, youth and students, children, and urban poor;

(c) *"Cooperative"* — Refers to a duly registered association of at least fifteen (15) persons, majority of which are poor, having a common bond of interest, who voluntarily join together to achieve a lawful common social and economic end. It is organized by the members who equitably contribute the required share capital and accept a fair share of the risks and benefits of their undertaking in accordance with the universally accepted corporate principles and practices;

(d) *"Capability building"* — Refers to the process of enhancing the viability and sustainability of microfinance institutions through activities that include training in microfinance technologies, upgrading of accounting and auditing

systems, technical assistance for the installation or improvement of management information systems, monitoring of loans and other related activities. The term capability building shall in no way refer to the provision of equity investments, seed funding, partnership's seed funds, equity participation, start-up funds or any such activity that connotes the infusion of capital or funds from the government or from the people's development trust fund to microfinance institution as defined in this Act. Capability building precludes the grant of any loan or equity funds to the microfinance institution;

(e) *"Collateral-free arrangement"* — A financial arrangement wherein a loan is contracted by the debtor without the conventional loan security of a real estate or chattel mortgage in favor of the creditor. In lieu of these conventional securities, alternative arrangements to secure the loans and ensure repayment are offered and accepted;

(f) *"Group character loan"* — A loan contracted by a member and guaranteed by a group of persons for its repayment. The creditor can collect from any of the members of the group which guaranteed the said loan, without prejudice to the right of reimbursement of the member or members of the group who had advanced the payment in favor of the actual debtor;

(g) *"Indigenous cultural communities/ indigenous peoples"* — As defined in Republic Act No. 8371, otherwise known as *"The Indigenous Peoples Rights Act of 1997"*;

(h) *"Migrant workers"* — As defined in Republic Act No. 8042, otherwise known as the *"Migrant Workers and Overseas Filipino Act of 1995"*;

(i) *"Micro-enterprise"* — Any economic enterprise with a capital of One hundred fifty thousand pesos (P150,000.00) and below. This amount is subject to periodic determination of the Department of Trade and Industry to reflect economic changes;

(j) *"Microfinance"* — A credit and savings mobilization program exclusively for the poor to improve the asset base of households and expand the access to savings of the poor. It involves the use of viable alternative credit schemes and savings programs including the extension of small loans, simplified loan application procedures, group character loans, collateral-free arrangements, alternative loan repayments, minimum requirements for savings, and small denominated savers' instruments;

(k) *"Minimum basic needs"* — Refers to the needs of a Filipino family pertaining to survival (food and nutrition; health; water and sanitation; clothing), security (shelter; peace and order; public safety; income and livelihood) and enabling (basic education and literacy; participation in

community development; family and psycho-social care);

(l) ***"Human development index"*** — Refers to the measure of how well a country has performed, based on social indicators of people's ability to lead a long and healthy life, to acquire knowledge and skills, and to have access to the resources needed to afford a decent standard of living. This index looks at a minimum of three outcomes of development: the state of health (measured by life expectancy at birth), the level of knowledge and skill (measured by a weighted average of adult literacy and enrollment rates), and the level of real income per capita, adjusted for poverty considerations;

(m) ***"Non-government organizations"*** — Refers to duly registered non-stock, non-profit organizations focusing on the upliftment of the basic or disadvantaged sectors of society by providing advocacy, training, community organizing, research, access to resources, and other similar activities;

(n) ***"People's organization"*** — Refers to a self-help group belonging to the basic sectors and/or disadvantaged groups composed of members having a common bond of interest who voluntarily join together to achieve a lawful common social or economic end;

(o) ***"Poor"*** — Refers to individuals and families whose income fall below the poverty threshold as defined by the National Economic and Development Authority and/or cannot afford in a sustained manner to provide their minimum basic needs of food, health, education, housing and other essential amenities of life;

(p) ***"Poverty alleviation"*** — Refers to the reduction of absolute poverty and relative poverty;

(q) ***"Absolute poverty"*** — Refers to the condition of the household below the food threshold level;

(r) ***"Relative poverty"*** — Refers to the gap between the rich and the poor;

(s) ***"Social reform"*** — Refers to the continuing process of addressing the basic inequities in Filipino society through a systematic, unified and coordinated delivery of socioeconomic programs or packages;

(t) ***"Small Savers Instrument (SSI)"*** — Refers to an evidence of indebtedness of the Government of the Republic of the Philippines which shall be in small denominations and sold at a discount from its redemption value, payable to bearer and redeemable on demand according to a schedule printed on the instrument, with a discount lower than the full stated rate if not held to maturity. The resources generated under this scheme shall be used primarily for micro-credit for the poor. SSIs are not eligible as legal reserve of banks

and legal reserves prescribed of insurance companies operating in the Philippines;

(u) *"Urban poor"* — Refers to individuals or families residing in urban centers and urbanizing areas whose income or combined household income falls below the poverty threshold as defined by the National Economic and Development Authority and/or cannot afford in a sustained manner to provide their minimum basic needs of food, health, education, housing and other essential amenities of life;

(v) *"Workers in the formal sector"* — Refers to workers in registered business enterprises who sell their services in exchange for wages and other forms of compensation;

(w) *"Workers in the informal sector"* — Refers to poor individuals who operate businesses that are very small in scale and are not registered with any national government agency, and to the workers in such enterprises who sell their services in exchange for subsistence level wages or other forms of compensation; and

(x) *"Youth"* — Refers to persons fifteen (15) to thirty (30) years old.

SECTION 4. *Adoption and integration of Social Reform Agenda (SRA) in the National Anti-Poverty Action Agenda.* — The National Anti-Poverty Action Agenda shall principally include the core principles and programs of the Social Reform Agenda (SRA). The SRA shall have a multi-dimensional approach to poverty consisting of the following reforms:

(1) *Social dimension access to quality basic services.* — These are reforms which refer to equitable control and access to social services and facilities such as education, health, housing, and other basic services which enable the citizens to meet their basic human needs and to live decent lives;

(2) *Economic dimension asset reform and access to economic opportunities.* — Reforms which address the existing inequities in the ownership, distribution, management and control over natural and man-made resources from which they earn a living or increase the fruits of their labor;

(3) *Ecological dimension sustainable development of productive resources.* — Reforms which ensure the effective and sustainable utilization of the natural and ecological resource base, thus assuring greater social acceptability and increased participation of the basic sectors in environmental and natural resources conservation, management and development;

(4) *Governance dimension democratizing the decision-making and management processes.* — Reforms which enable the basic sectors to

effectively participate in decision-making and management processes that affect their rights, interests and welfare.

The SRA shall focus on the following sector-specific flagship programs:

- (1) *For farmers and landless rural workers* — agricultural development;
- (2) *For the fisherfolk* — fisheries and aquatic resources conservation, management and development;
- (3) For the indigenous peoples and indigenous communities — respect, protection and management of the ancestral domains;
- (4) *For workers in the informal sector* — workers' welfare and protection;
- (5) *For the urban poor* — socialized housing; and
- (6) *For members of other disadvantaged groups such as the women, children, youth, persons with disabilities, the elderly, and victims of natural and man-made calamities* — the Comprehensive Integrated Delivery of Social Services (CIDSS).

Additionally, to support the sectoral flagship programs, the following cross-sectoral flagships shall likewise be instituted:

- (1) Institution-building and effective participation in governance;
- (2) Livelihood programs;
- (3) Expansion of micro-credit/microfinance services and capability building; and
- (4) Infrastructure buildup and development.

TITLE I NATIONAL ANTI-POVERTY COMMISSION

SECTION 5. *The National Anti-Poverty Commission.* — To support the above-stated policy, the National Anti-Poverty Commission, hereinafter referred to as the NAPC, is hereby created under the Office of the President, which shall serve as the coordinating and advisory body for the implementation of the SRA. The Presidential Commission to Fight Poverty (PCFP), the Social Reform Council (SRC), and the Presidential Council for Countryside Development (PCCD) are hereby abolished and the NAPC shall exercise the powers and functions of these agencies. The NAPC shall be the successor-in-interest of the three (3) abolished commissions and councils.

The creation and operationalization of the NAPC shall be guided by the following principles:

- (1) Incorporation of the Social Reform Agenda into the formulation of development plans at the national, regional, sub-regional and local levels;**
- (2) Efficiency in the implementation of the anti-poverty programs by strengthening and/or streamlining present poverty alleviation processes and mechanisms, and reducing the duplication of functions and activities among various government agencies;**
- (3) Coordination and synchronization of social reform and poverty alleviation programs of national government agencies;**
- (4) Exercise of policy oversight responsibilities to ensure the attainment of social reform and poverty alleviation goals;**
- (5) Strengthening of local government units to more effectively operationalize the SRA in local development efforts;**
- (6) Institutionalization of basic sectoral and NGO participation in effective planning, decision-making, implementation, monitoring and evaluation of the SRA at all levels;**
- (7) Ensuring adequate, efficient and prompt delivery of basic services to the poor; and**
- (8) Enjoining government financial institutions to open credit and savings windows for the poor, and advocating the creation of such windows for the poor among private banking institutions.**

SECTION 6. *Composition of the NAPC.* — The President of the Republic of the Philippines shall serve as Chairperson of the NAPC. The President shall appoint the Lead Convenor of the NAPC, either from the government or private sector, who shall likewise serve as the head of the National Anti-Poverty Commission Secretariat, and shall have the rank of a Cabinet Secretary. There shall be a vice-chairperson for the government sector and a vice-chairperson for the basic sectors; the former to be designated by the President, and the latter to be elected among the basic sector representatives of the NAPC as vice-chairperson for the basic sector; and the following as members:

- (1) Heads of the following government bodies:**
 - (a) Department of Agrarian Reform (DAR);**
 - (b) Department of Agriculture (DA);**

- (c) Department of Labor and Employment (DOLE);**
- (d) Department of Budget and Management (DBM);**
- (e) Department of Social Welfare and Development (DSWD);**
- (f) Department of Health (DOH);**
- (g) Department of Education, Culture and Sports (DECS);**
- (h) Department of the Interior and Local Government (DILG);**
- (i) Department of Environment and Natural Resources (DENR);**
- (j) Department of Finance (DOF);**
- (k) National Economic and Development Authority (NEDA);**
- (l) People's Credit and Finance Corporation (PCFC), subject to Section 17 of this Act; and**
- (m) Presidential Commission on Urban Poor (PCUP).**

(2) Presidents of the Leagues of Local Government Units:

- (a) League of Provinces;**
- (b) League of Cities;**
- (c) League of Municipalities;**
- (d) Liga ng mga Barangay.**

(3) Representatives from each of the following basic sectors:

- (a) Farmers and landless rural workers;**
- (b) Artisanal fisherfolk;**
- (c) Urban poor;**
- (d) Indigenous cultural communities/indigenous peoples;**
- (e) Workers in the formal sector and migrant workers;**
- (f) Workers in the informal sector;**
- (g) Women;**
- (h) Youth and students;**
- (i) Persons with disabilities;**
- (j) Victims of disasters and calamities;**
- (k) Senior citizens;**
- (l) Nongovernment organizations (NGOs);**
- (m) Children; and**
- (n) Cooperatives.**

Sectoral councils formed by and among the members of each sector shall respectively nominate three (3) nominees from each sector within six (6) months after the effectivity of the implementing rules and regulations of this Act, and every three (3) years thereafter and in case of vacancy. The President of the Republic of the Philippines shall, within (30) days after the submission of the list of nominees, appoint the representatives from the submitted list. Sectoral representatives shall serve for a term of three (3) years without reappointment. Appointment to any vacancy for basic sector representatives shall be only for the unexpired term of the predecessor.

The implementing rules and regulations (IRR) of this Act shall contain the guidelines for the formation of sectoral councils, the nomination process, recall procedures and such other mechanisms to ensure accountability of the sectoral representatives.

SECTION 7. *Powers and functions.* — The NAPC shall exercise the following powers and functions:

- (1) Coordinate with different national and local government agencies and the private sector to assure full implementation of all social reform and poverty alleviation programs;**
- (2) Coordinate with local government units in the formulation of social reform and poverty alleviation programs for their respective areas in conformity with the National Anti-Poverty Action Agenda;**
- (3) Recommend policy and other measures to ensure the responsive implementation of the commitments under the SRA;**
- (4) Ensure meaningful representation and active participation of the basic sectors;**
- (5) Oversee, monitor and recommend measures to ensure the effective formulation, implementation and evaluation of policies, programs and resource allocation and management of social reform and poverty alleviation programs;**
- (6) Advocate for the mobilization of funds by the national and local governments to finance social reform and poverty alleviation programs and capability building activities of people's organizations;**
- (7) Provide financial and non-financial incentives to local government units with counterpart resources for the implementation of social reform and poverty alleviation programs; and**
- (8) Submit an annual report to Congress including, but not limited to, all aspects of its operations and programs and project implementation, financial status and other relevant data as reflected by the basic reform indicator.**

SECTION 8. *Principal office.* — The NAPC shall establish its principal office in Metro Manila and may establish such branches within the Philippines as may be deemed necessary by the President of the Philippines to carry out the powers and functions of the NAPC.

SECTION 9. *The NAPC secretariat.* — The NAPC shall be supported by a Secretariat, which shall be headed by the Lead Convenor referred to under Section

6 hereof. The Secretariat shall provide technical and administrative support to the NAPC. It shall be formed from the unification of the secretariats of the following bodies:

(1) Presidential Commission to Fight Poverty (PCFP);

(2) Social Reform Council (SRC); and

(3) Presidential Council for Countryside Development (PCCD).

Within three (3) months from the effectivity of this Act, the Office of the President shall finalize the organizational plan for the NAPC.

To provide the continuity of existing social reform and poverty alleviation related programs, all accredited organizations under the three (3) unified councils and commissions shall be automatically accredited under the NAPC until such time that additional accreditation requirements may be provided by the NAPC.

SECTION 10. *The People's Development Trust Fund.* — The People's Development Trust Fund (PDTF) is hereby established, which shall be monitored by the NAPC.

The Trust Fund in the amount of Four billion and five hundred million pesos (P4,500,000,000.00) shall be funded from the earnings of the PAGCOR in addition to appropriations by Congress, voluntary contributions, grants, gifts from both local and foreign sources as may be accepted or decided on by the NAPC. Any additional amount to the Trust Fund shall form part of the corpus of the Trust Fund, unless the donor, contributor or grantor expressly provides as a condition that the amount be included in the disburseable portion of the Trust Fund.

The President of the Philippines shall assign to any existing government department or agency the administration of the Trust Fund, based on the expertise, organizational capability, and orientation or focus of the department or agency. The NAPC shall be limited to the function of monitoring the utilization of the PDTF, while the government departments or agencies designated by the President shall directly administer the utilization of the earnings of the PDTF.

Only the fruits of the PDTF shall be used for the purposes provided in this Act. Any undisbursed fruits for the preceding year shall form part of the disburseable portion of the PDTF in the following year.

For the purpose of monitoring the earnings of the PDTF, the NAPC shall:

(1) Source funds for the establishment of and augmentation to the Trust Fund;

(2) Recommend to the appropriate government department or agency the accreditation of organizations and institutions that shall act as resource partners in conducting institutional development and capability building activities for accredited organizations and beneficiaries of microfinance and

micro-enterprise programs;

(3) Ensure that validation and monitoring activities are conducted for funded institutional development and capability building projects/programs/beneficiaries; and

(4) Promote research and development work on livelihood and microfinance technology and publications/communications programs that assist the poor beneficiaries.

SECTION 11. *Purposes of the People's Development Trust Fund (PDTF).* — The earnings of the PDTF shall be utilized for the following purposes:

(1) Consultancy and training services for microfinance institutions and their beneficiaries on the establishment of the necessary support services, social and financial preparation of beneficiaries, preparation of plans and programs including fund sourcing and assistance, establishment of credit and savings monitoring and evaluation mechanisms;

(2) Scholarships or training grants for microfinance staff and officers, and selected beneficiaries;

(3) Community organizing for microfinance, livelihood and micro-enterprises training services;

(4) Livelihood/micro-enterprise project/program feasibility studies and researches;

(5) Savings mobilization and incentive programs, and other similar facilities;

(6) Information and communication systems such as baseline surveys, development monitoring systems, socioeconomic mapping surveys, organizational assessments, and other similar activities;

(7) Legal and other management support services such as registration, documentation, contract review and enforcement, financial audit and operational assessment;

(8) Information dissemination of microfinance technology; and

(9) Other activities to support microfinance as approved by the designated agency administering the PDTF.

The PDTF may be accessed by the following:

- (a) Registered microfinance organizations engaged in providing micro-enterprise services for the poor to enable them to become viable and sustainable;**
- (b) Local government units providing microfinance and micro-enterprise programs to their constituents: *Provided*, That the PDTF shall not be used by the LGUs for personal services and maintenance and other operating expenses; and**
- (c) Local government units undertaking self-help projects where at least twenty-five percent (25%) of the total earnings of the PDTF shall be used exclusively for the provision of materials and technical services.**

SECTION 12. *The role of Local Government Units (LGUs).* — The local government units, through the local development councils of the province, city, municipality, or barangay shall be responsible for the formulation, implementation, monitoring and evaluation of the National Anti-Poverty Action Agenda in their respective jurisdictions. The LGUs shall:

- (a) Identify the poor in their respective areas based on indicators such as the minimum basic needs approach and the human development index, their location, occupation, nature of employment, and their primary resource base and formulate a provincial/city/municipality anti-poverty action agenda;**
- (b) Identify and source funding for specific social reform and poverty alleviation projects;**
- (c) Coordinate, monitor and evaluate the efforts of local government units with the private sector on planning and implementation of the local action program for social reform and poverty alleviation; and**
- (d) Coordinate and submit progress reports to the National Anti-Poverty Commission regarding their local action programs.**

Nothing in this Act shall be construed as diminishing the powers granted to the local government units under the Local Government Code.

TITLE II MICROFINANCE SERVICES FOR THE POOR

SECTION 13. *Microfinance program.* — The programs and implementing mechanisms of the Social Reform Agenda's Flagship Program on Credit shall be integrated, adopted and further enhanced to effectively support the objectives of this Act along the following thrusts:

- (1) Development of a policy environment, especially in the area of savings generation, supportive of basic sector initiatives dedicated to serving the needs of the poor in terms of microfinance services;**
- (2) Rationalization of existing government programs for credit and guarantee;**
- (3) Utilization of existing government financial entities for the provision of microfinance products and services for the poor; and**
- (4) Promotion of mechanisms necessary for the implementation of microfinance services, including indigenous microfinance practices.**

SECTION 14. *People's Credit and Finance Corporation (PCFC).* — The People's Credit and Finance Corporation (PCFC), a government- controlled corporation registered with the Securities and Exchange Commission and created in accordance with Administrative Order No. 148 and Memorandum Order No. 261, shall be the vehicle for the delivery of microfinance services for the exclusive use of the poor. As a government-owned and -controlled corporation, it shall be the lead government entity specifically tasked to mobilize financial resources from both local and international funding sources for microfinance services for the exclusive use of the poor.

SECTION 15. *Increase in the Capitalization of PCFC.* — To facilitate the increase in the capitalization of the PCFC, the President of the Republic of the Philippines shall take measures to enable the amendment of the Articles of Incorporation of the PCFC such that:

- (a) The authorized capital stock of the PCFC may be increased from One hundred million pesos (P100,000,000.00) to Two billion pesos (P2,000,000,000.00) divided into twenty million common shares with a par value of One hundred pesos (P100.00) per share;**
- (b) The subscribed capital stock may be increased from One hundred million pesos (P100,000,000.00) to Six hundred million pesos (P600,000,000.00) and the national government may subscribe the difference of Five hundred million pesos (P500,000,000.00);**
- (c) The initial paid-up capital may be increased from One hundred million pesos (P100,000,000.00) to Two hundred fifty million pesos (P250,000,000.00), to be increased subsequently to a total of Six hundred million pesos (P600,000,000.00), such that at the end of a period of four (4) years the subscribed capital shall be fully paid-up, in the following manner:**

For the initial increase in paid-up capital during the first year, the difference of One hundred fifty million pesos (P150,000,000.00) shall

be paid and appropriated for by government; for the second year, One hundred fifty million pesos (P150,000,000.00); for the third year, One hundred million pesos (P100,000,000.00); and for the fourth year, One hundred million pesos (P100,000,000.00).

The appropriations for the additional paid-up capital shall be sourced from the share of the national government in the earnings of the PAGCOR, in the manner provided for under Section 18, which provides for the appropriations under this Act.

SECTION 16. *Special credit windows in existing Government Financing Institutions (GFIs).* — The existing government financial institutions shall provide for the savings and credit needs of the poor. The GFIs such as the Land Bank of the Philippines, Philippine Postal Bank, Al Amanah Bank, and the Development Bank of the Philippines are hereby mandated to coordinate with NAPC and PCFC in setting up special credit windows and other arrangements, such as the servicing of Small Savers Instruments (SSIs), that will promote the microfinance program of this Act.

The private financing institutions may also provide the savings and credit requirements of the poor by setting up similar credit windows and other arrangements to promote the savings component of the microfinance program of this Act.

Special credit windows for the poor shall, as far as practicable, include an allocation for the basic sectors, as defined in this Act, particularly those living in the rural areas, agrarian reform communities, and women in the countryside.

SECTION 17. *PCFC privatization.* — In the event that the ownership of the majority of the issued voting stocks of PCFC shall have passed to private investors (exclusively qualified nongovernment organizations, people's organizations and cooperatives), the stockholders shall cause the registration with the Securities and Exchange Commission (SEC) of the revised Articles of Incorporation and By-laws. The PCFC shall thereafter be considered as a privately organized entity subject to the laws and regulations generally applied to private corporations.

The chairman of the PCFC may still be a member of the National Anti-Poverty Commission (NAPC) upon the privatization of the PCFC: Provided, That the PCFC will continue its main purpose of providing for the savings and credit needs of the poor.

TITLE III
APPROPRIATIONS FOR
THE NATIONAL ANTI-POVERTY COMMISSION (NAPC)
AND THE PEOPLE'S DEVELOPMENT TRUST FUND (PDTF)

SECTION 18. *Appropriations.* — To carry out the provisions of this Act, the following amounts are appropriated as follows:

(1) The sum of One hundred million pesos (P100,000,000.00) is hereby appropriated as the initial operating fund in addition to the unutilized funds of the rationalized commission and councils. The sum shall be sourced from the President's Contingent Fund. In subsequent years, the amount necessary to implement this Act shall be included in the annual appropriations. The said amounts shall be under the management of the NAPC.

(2) The aggregate sum of Four billion and five hundred million pesos (P4,500,000,000.00) for ten (10) years is hereby appropriated for the establishment of the People's Development Trust Fund (PDTF) from the share of the national government in the earnings of the Philippine Amusement and Gaming Corporation (PAGCOR), in the following manner: on the first year, Three hundred fifty million pesos (P350,000,000.00); on the second year, Three hundred fifty million pesos (P350,000,000.00); on the third year, Four hundred million pesos (P400,000,000.00); on the fourth year, Four hundred million pesos (P400,000,000.00); on the fifth year and every year thereafter until the tenth year, Five hundred million pesos (P500,000,000.00) annually.

(3) The aggregate sum of Five hundred million pesos (P500,000,000) for four years shall be appropriated for the increase in the capitalization of the PCFC, from the share of the national government in the earnings of the PAGCOR, at such time that the increase in the capitalization of the PCFC, in the manner provided for under Section 15 of this Act, shall have been effected. The appropriation shall be made in the following manner: on the first year, One hundred fifty million pesos (P150,000,000.00); on the second year, One hundred fifty million pesos (P150,000,000.00); on the third year, One hundred million pesos (P100,000,000.00); and on the fourth year, One hundred million pesos (P100,000,000.00).

SECTION 19. *Transitory provision.* — The Social Reform Council (SRC) and the representatives therein shall, in temporary capacity, exercise the powers and assume the duties of the NAPC until such time that the members of NAPC shall have been duly appointed or designated.

The Office of the President shall formulate the implementing rules and regulations (IRR) of this Act within six (6) months after its effectivity.

The assets, liabilities and personnel of PCFP, SRC and PCCD are hereby transferred to the NAPC. Personnel who cannot be absorbed by NAPC shall be entitled to a separation pay of one-and-a-half (1 1/2) months for every year of service and other benefits under existing retirement laws, at the option of the personnel concerned.

SECTION 20. *Repealing clause.* — All laws, executive orders, rules and regulations, or parts thereof, inconsistent with this Act are hereby repealed, amended or modified accordingly. The provisions of this Act shall not be repealed, amended or modified unless expressly provided in subsequent general or special laws.

SECTION 21. *Separability clause.* — If any provision of this Act shall be held invalid or unconstitutional, the remaining provisions thereof not affected thereby shall remain in full force and effect.

SECTION 22. *Effectivity clause.* — This Act shall be effective on June 30, 1998.

Approved: December 11, 1997

AGRICULTURE AND FISHERIES MODERNIZATION ACT OF 1997

[An Act Prescribing Urgent Related Measures to Modernize the Agriculture and Fisheries Sectors of the Country in Order to Enhance Their Profitability, and Prepare Said Sectors for the Challenges of the Globalization Through an Adequate, Focused and Rational Delivery of Necessary Support Services, Appropriating Funds Therefor and For Other Purposes]

SECTION 1. *Short Title.* - This act shall be known as the "*Agriculture and Fisheries Modernization Act of 1997.*"

SEC. 2. *Declaration of Policy.* - The goals of the national economy are more equitable distribution of opportunities, income and wealth; a sustained increase in the amount of goods and services produced by the nation for the benefit of the people; and an expanding productivity as the key to raising the quality of life for all, especially the underprivileged.

The State shall promote industrialization and full employment based on sound agricultural development and agrarian reform, through industries that make full and efficient use of human and natural resources, and which are competitive in both domestic and foreign markets. In pursuit of these goals, all sectors of the economy and all regions of the country shall be given optimum opportunity to develop. Private enterprises, including corporations, cooperatives, and similar collective organizations, shall be encouraged to broaden the base of their ownership.

Thus, it is hereby declared the policy of the State to enable those who belong to the agriculture and fisheries sectors to participate and share in the fruits of development and growth in a manner that utilizes the nations resources in the most efficient and sustainable way possible by establishing a more equitable access to assets, income, basic and support services and infrastructure.

The State shall promote food security, including sufficiency in our staple food, namely rice and white corn. The production of rice and white corn shall be optimized to meet our local consumption and shall be given adequate support by the State.

The State shall adopt the market approach in assisting the agriculture and fisheries sectors while recognizing the contribution of the said sector to food security, environmental protection, and balanced urban and rural development, without neglecting the welfare of the consumers, especially the lower income groups. The state shall promote market-oriented policies in agricultural production to encourage farmers to shift to more profitable crops.

The state shall empower the agricultural and fisheries sector to develop and sustain themselves. Toward this end, the State shall ensure the development of the agriculture and fisheries sectors in accordance with the following principles:

a) *Poverty Alleviation and Social Equity.* - The State shall ensure that the poorer sectors of society have equitable access to resources, income opportunities, basic and support services and infrastructure especially in areas where productivity is low as a means of improving their quality of life compared with other sectors of society;

b) *Food Security.* - The State shall assure the availability, adequacy, accessibility of food supplies to all at all times;

c) *Rational Use of Resources.* - The State shall adopt a rational approach in the allocation of public investments in agriculture and fisheries in order to assure efficiency and effectiveness in the use of scarce resources and thus obtain optimal returns on its investments;

d) *Global Competitiveness.* - The State shall enhance the competitiveness of the agriculture and fisheries sectors in both domestic and foreign markets;

e) *Sustainable Development.* - The State shall promote development that is compatible with the preservation of the ecosystem in areas where agriculture and fisheries activities are carried out. The State should exert care and judicious use of the country's natural resources in order to attain long-term sustainability;

f) *People Empowerment.* - The State shall promote people empowerment by enabling all citizens through direct participation or through their duly elected, chosen or designated representatives the opportunity to participate in policy formulation and decision-making by establishing the appropriate mechanisms and by giving them access to information; and

g) *Protection from Unfair Competition.* - The State shall protect small farmers and fisher folk from unfair competition such as monopolistic and oligopolistic practices by promoting a policy environment that provides them priority access to credit and strengthened cooperative-based marketing system.

SEC. 3. *Statement of Objectives.* - This Act shall have the following objectives:

a) To modernize the agriculture and fisheries sectors by transforming these sectors from a resource-based to a technology-based industry;

b) To enhance profits and incomes in the agriculture and fisheries sectors, particularly the small farmers and fisherfolk, by ensuring equitable access to assets, resources and services, and promoting higher-value crops, value-added processing, agribusiness activities, and agro-industrialization;

c) To ensure the accessibility, availability and stable supply of food to all at all times;

d) To encourage horizontal and vertical integration, consolidation and expansion of agriculture and fisheries activities, group functions and other services through the organization of cooperatives, farmers' and fisherfolk's associations, corporations, nucleus estates, and consolidated farms and to enable these entities to benefit from economies of scale, afford them a stronger negotiating position, pursue more focused, efficient and appropriate research and development efforts and enable them to hire professional managers;

e) To promote people empowerment by strengthening people's organizations, cooperatives and NGO's and by establishing and improving mechanisms and resources for their participation in government decision-making and implementation;

f) To pursue a market-driven approach to enhance the comparative advantage of our agriculture and fisheries sectors in the world market;

g) To induce the agriculture and fisheries sectors to ascend continuously the value-added ladder by subjecting their traditional or new products to further processing in order to minimize the marketing of raw, unfinished or unprocessed products;

h) To adopt policies that will promote industry dispersal and rural industrialization by providing incentives to local and foreign investors to establish industries that have backward linkages to the country's agriculture and fisheries resource base;

i) To provide social and economic adjustment measures that increase productivity and improve market efficiency while ensuring the protection and preservation of the environment and equity for small farmers and fisherfolk; and

j) To improve the quality of life of all sectors.

SEC. 4. *Definition of Terms.* -

"Agrarian Reform Community" is a barangay at the minimum or a cluster of contiguous barangays where there is a critical mass of farmers or farm workers and which features the main thrust of agrarian development land tenure improvement and effective delivery of support services.

"Agricultural Lands" refers to lands devoted to or suitable for the cultivation of the soil, planting of crops, growing of trees, raising of livestock, poultry, fish or aquiculture production, including the harvesting of such farm products, and other farm activities and practices performed in conjunction with such farming operations by persons whether natural or juridical and not classified by the law as mineral land, forest land, residential land, commercial land, or industrial land.

"Agricultural Land Use Conversion" refers to the process of changing the use of agricultural land to non-agricultural uses.

"Agricultural Sector" is the sector engaged in the cultivation of the soil, planting of crops, growing of fruit trees, raising of livestock, poultry, or fish, including the harvesting and marketing off such farm products, and other farm activities and practices.

"Agricultural Mechanization" is the development, adoption, manufacture and application of appropriate location-specific, and cost-effective agricultural technology using human, animal, mechanical, electrical and other non-conventional sources of energy for agricultural production and post-harvest operations consistent with agronomic conditions and for efficient and economic farm management.

"Agriculture and Fisheries Modernization" is the process of transforming the agriculture and fisheries sectors into one that is dynamic, technologically advanced and competitive yet centered on human development guided by the sound practices of sustainability and the principles of social justice.

"Agro-Processing Activities" refers to the processing of raw agricultural and fishery products into semi-processed or finished products which include materials for the manufacture for food and/or non-food products, pharmaceuticals and other industrial products.

"Banks", collective used, means government banks and private banks, rural banks and cooperative banks.

"Basic Needs Approach to Development" involves the identification, production and marketing of wage goods and services for consumption of rural communities.

"Communal Irrigation System (CIS)" is an irrigation system that is managed by a bona fide Irrigators Association.

"Competitive Advantage" refers to competitive edge in terms of product quality and/or price. It likewise refer to the ability to produce a product with the greatest relative efficiency in the use of resources.

"Cooperatives" refers to duly registered associations of persons with a common bond of interest who have voluntarily joined together to achieve a lawful common social and economic end, making equitable contributions to the capital required and accepting a fair share of the risks and benefits of the undertaking in accordance with universally accepted cooperatives principles.

"Department" refers to the Department of Agriculture.

"Economic Scale " refers to the minimum quantity of volume of goods required to be efficient.

"Economies of Scale" refers to the decrease in unit cost as more units are produced due to the spreading out of fixed costs over a greater number of units produced.

"Empowerment" involves providing authority, responsibility and information to people directly engaged in agriculture and fishery production, primarily at the level of the farmers, fisher folk and those engaged in food and non-food production and processing, in order to give them wider choices and enable them to take advantage of the benefits of the agriculture and fishery industries.

"Extension Services" refers to the provision of training, information, and support services by the government and non-government organizations to the agriculture and fisheries sectors to improve the technical, business, and social capabilities of farmers and fisher folk.

"Farmer's and Fisherfolk's Organizations or Associations" refer to farmers and fisherfolks cooperatives, associations or corporations duly registered with appropriate government agencies and which are composed primarily of small agricultural producers, farmers, farm, workers, agrarian reform beneficiaries, fisher folk who voluntarily join together to form business enterprises or non-business organizations which they themselves own, control and patronize.

"Farm-to-Market Roads" refer to roads linking the agriculture and fisheries production sites, coastal landing points and post-harvest facilities to the market and arterial roads and highways.

"Fisheries" refers to all systems or networks of interrelated activities which include the production, growing, harvesting, processing, marketing, developing, conserving, and managing of all aquatic resources and fisheries areas.

"Fisheries Sector" is the sector engaged in the production, growing, harvesting, processing, marketing, developing, conserving, and managing of aquatic resources and fisheries areas.

"Fishing" refers to the application of techniques using various gear in catching fish and other fisheries products.

"Fishing Grounds" refers to areas in any body of water where fish and other aquatic resources congregate and become target of capture.

"Food Security" refers to the policy objective, plan and strategy of meeting the food requirements of the present and future generations of Filipinos in substantial quantity, ensuring the availability and affordability of food to all, either through local production or importation, of both, based on the country's existing and potential resource endowment and related production advantages, and consistent with the over all national development objectives and policies. However, sufficiency in rice and white corn should be pursued.

"Fresh Agricultural And Fishery Products" refers to agricultural and fisheries products newly taken or captured directly from its natural state or habitat, or those newly harvested or gathered from agricultural areas or bodies of water used for aquiculture.

"Global Competitiveness" refers to the ability to compete in terms of price, quality and value of agriculture and fishery products relative to those of other countries.

"Gross Value-Added" refers to the total value, excluding the value of non-agricultural of fishery intermediate inputs, of goods and services contributed by the agricultural and fisheries sectors.

"Head works" refers to the composite parts of the irrigation system that divert water from natural bodies of water such as river, streams, and lakes.

"Industrial Dispersal" refers to the encouragement given to manufacturing enterprises to establish their plants in rural areas. Such firms normally use agricultural raw materials either in their primary or intermediate state.

"Irrigable Lands" refers to lands which display marked characteristics justifying the operation of an irrigation system.

"Irrigated Lands" refers to lands serviced by natural irrigation or irrigation facilities. These include lands where water is not readily available as existing irrigation facilities need rehabilitation or upgrading or where irrigation water is not available year-round.

"Irrigation System" refers to a system of irrigation facilities covering contiguous areas.

"Irrigators' Association (IA)" refers to an association of farmers within a contiguous area served by a National Irrigation System or Communal Irrigation System.

"Land Use" refers to the manner of utilizing the land, including its allocation, development and management.

"Land Use Plan" refers to a document embodying a set of policies accompanied by maps and similar illustrations which represent the community-deserved pattern of population distribution and a proposal for the future allocation of land to the various land-using activities, in accordance with the social and economic objectives of the people. It identifies the location, character and extent of the area's land resources to be used for different purposes and includes the process and the criteria employed in the determination of the land use.

"Land Use Planning" refers to the act of defining the allocation, utilization, development and management of all lands within a given territory or jurisdiction according to the inherent qualities of the land itself and supportive of sustainable, economic, demographic, socio-cultural and environmental objectives as an aid to decision-making and legislation.

"Main Canal" refers to the channel where diverted water from a source flows to the intended area to be irrigated.

"Market Infrastructure" refers to facilities including, but not limited to, market buildings, slaughterhouses, holding pens, warehouses, market information centers, connecting roads, transport and communication and cold storage used by the farmers and fisher folk in marketing their produce.

"National Information Network (NIN)" refers to an information network which links all offices and levels of the Department with various research institutions and local end-users, providing easy access to information and marketing services related to agriculture and fisheries.

"National Irrigation System (NIS)" refers to a major irrigation system managed by the National Irrigation Administration.

"Network of Protected Areas for Agricultural and Agro-industrial Development (NPAAD)" refers to agricultural areas identified by the Department through the Bureau of Soils and Water Management in coordination with the National Mapping and Resources Information Authority in order to ensure the efficient utilization of land for agriculture and Agro-industrial development and promote sustainable growth . The NPAAD covers all irrigated areas, all irrigable lands already covered by irrigation projects with firm funding commitments; all alluvial plain land highly suitable for agriculture whether irrigated or not; Agro-industrial crop lands or lands presently planted to industrial crops that support the viability of existing agricultural infrastructure and agro-based enterprises, highlands, areas located at an elevation of five hundred (500) meters or above and have the potential for growing semi temperate and high-value crops; all agricultural lands that are ecological fragile, the conversion of which will result in serious environmental degradation, and mangrove areas and fish sanctuaries.

"On-Farm Irrigation Facilities" refers to composite facilities that permit entry of water to paddy areas and consist of farm ditches and turnouts.

"Primary Processing" refers to the physical alteration of raw agricultural or fishery products with or without the use of mechanical facilities.

"Post-Harvest Facilities" includes, but is not limited to , threshing, drying, milling, grading , storing, and handling of produce and such other activities as stripping, winnowing, chipping and washing.

"Post -Harvest Facilities" includes, but it is not limited to, threshers, moisture meters, dryers, weighing scales, milling equipment, fish ports, fish landings, ice plants and cold storage facilities, processing plants, warehouses, buying stations, market infrastructure and transportation.

" Premature Conversion of Agricultural Land" refers to the undertaking of any development activity, the results of which modify or alter the physical characteristics of the agricultural lands to render them suitable for non-agricultural purposes, without an approved order of conversion from the DAR.

" Resource Accounting" refers to a tracking changes in the environment and natural resources biophysically and economically (in monetary terms)

"Resource-based" refers to the utilization of natural resources.

"Rural Industrialization" refers to the process by which the economy is transformed from one that is predominantly agricultural to one that is dominantly industrial and service-oriented. Agriculture provides the impetus and push for industry and services through the market that it creates, the labor that it absorbs, and the income that it generates which is channeled to industry and services. As development continues, with agriculture still an important sector, industry and services begin to generate income and markets and concomitantly increase their share of total income.

"Strategic Agriculture and Fisheries Development Zones (SAFDZ)" refers to the areas within the NAPAAD identified for production, Agro-Processing and marketing activities to help develop and

modernize, either the support of government, the agriculture and fisheries sectors in an environmentally and socio-cultural sound manner.

"Secondary Canal" refers to the channel connected to the main canal which distributes irrigation to specific areas.

"Secondary Processing" refers to the physical transformation of semi-processed agricultural or fishery products.

"Shallow Tube Well (STW)" refers to a tube or shaft vertically set into the ground for the purpose of bringing ground water to the soil surface from a depth of less than 20 meters by suction lifting.

"Small Farmers and Fisherfolk" refers to natural person dependent on small-scale subsistence farming and fishing activities as their primary source of income.

"Small and Medium Enterprise (SME)" refers to any business activity or enterprise engaged in industry, agribusiness and/or services, whether single proprietorship, cooperative, partnership or corporation whose total assets, inclusive of those arising from loans but exclusive of the land on which the particular business entity's office, plan and equipment are situated, must have value falling under the following categories:

Micro - not more than P 1,500,000

Small - P 1,500,001 to P 15,000,000

Medium - P15,000,001 to P 60,000,000

The Department, in consultation with the Congressional Oversight Committee on Agricultural and Fisheries Modernization, may adjust the above values as deemed necessary.

"Socio-culturally Sound" means the consideration of the social structure of the community such as leadership pattern, distribution of roles across gender and age groups, the diversity of religion and other spiritual beliefs, ethnicity and cultural diversity of the population.

"Technology-based" refers to utilization of technology.

"Zoning Ordinance" refers to a local legislation approving the development land use plan and providing for the regulations and other conditions on the uses of land including the limitation of the infrastructure that may be placed within the territorial jurisdiction of a city or municipality.

TITLE I

PRODUCTION AND MARKETING SUPPORT SERVICES

Chapter 1

Strategic Agricultural and Fisheries Development Zones

SEC. 5. *Declaration of Policy.* - It is the policy of the State to ensure that all sectors of the economy and all regions of the country shall be given optimum opportunity to develop through the rational and sustainable use of resources peculiar to each area in order to maximize agricultural productivity,

promote efficiency and equity and accelerate the modernization of the agriculture and fisheries sectors of the country.

SEC. 6. *Network of Areas for Agricultural and Agro-Industrial Development.* -The Department shall, within six (6) months after the approval of this Act, and in consultation with the local government units, appropriate government agencies, concerned non-government organizations (NGOs) and organized farmers' and fisherfolk's groups, identify the strategic Agriculture and Fisheries Development Zones (SAFDZ) within the network of protected areas for agricultural and agro-industrial development to ensure that lands are efficiently and sustainably utilized for food and non-food production and agro-industrialization.

The SAFDZ which shall serve as centers where development in the agriculture and fisheries sectors are catalyzed in an environmentally and socio-cultural sound manner, shall be identified on the basis of the following criteria

- a. Agro-climatic and environmental conditions giving the area a competitive advantage in the cultivation, culture, production and processing of particular crops, animals and aquatic products;
- b. Strategic location of the area for the establishment of agriculture or fisheries infrastructure, industrial complexness, production and processing zones;
- c. Strategic location and of the area for market development and market networking both at the local and international levels; and
- d. Dominant presence of agrarian reform communities (ARCs) and/or small owner-cultivators and amortizing owners/agrarian reform beneficiaries and other small farmers and fisher folk in the area.

The SAFDZ shall have an integrated development plan consisting of production, processing, investment, marketing, human resources and environmental protection components.

SEC. 7. *Modern Farms.* - The Department in coordination with the local government units (LGUs) and appropriate government agencies, may designate agrarian reform communities (ARCs) and other areas within the SAFDZ suitable for economic scale production which will serve as model farms.

Farmer-landowners whose lands are located within these designated areas shall be given the option to enter into a management agreement with corporate entities with proven competence in farm operations and management, high-end quality production and productivity through the use of up-to-date technology and collateral resources such as skilled manpower, adequate capital and credit, and access to markets, consistent with the existing laws.

SEC. 8. *Mapping.* - The Department, through the Bureau of Soils and Water Management (BSWM), in coordination with the National Mapping and Resource Information Authority (NAMRIA) and the Housing and Land Use Regulatory Board (HLURB) shall undertake the mapping of network of areas for agricultural and agro-industrial development for all municipalities, cities and an appropriate scale. The BSWM may call on other agencies to provide technical and other logistical support in this undertaking.

SEC. 9. *Delineation of Strategic Agriculture and Fisheries Development Zones.* - The Department, in consultation with the Department of Agrarian Reform, the Department of Trade and Industry, the Department of Environment and Natural Resources, Department of Science and Technology, the concerned LGU's, the organized farmers and fisher folk groups, the private sector and communities shall, without prejudice to the development of identified economic zones and free ports, establish and

delineate based on sound resource accounting, the SAFDZ within one (1) year from the effectivity of this Act.

All irrigated lands, irrigable lands already covered by irrigation projects with firm funding commitments, and lands with existing or having the potential for growing high-value crops so delineated and included within the SAFDZ shall not be converted for a period of five (5) years from the effectivity for this Act: *Provided, however,* That not more than five percent (5%) of the said lands located within the SAFDZ may be converted upon compliance with existing laws, rules, regulations, executive order and issuances, and administrative orders relating to land use conversion: *Provided, further,* That thereafter 1) a review of the SAFDZ, specifically of the productivity of the areas, improvement of the quality of life of farmers and fisher folk, and efficiency and defectiveness of the support services shall be conducted by the Department and the Department of Agrarian Reform, in coordination with the Congressional Oversight Committee on Agricultural Committee and Fisheries Modernization; 2) conversion may be allowed, if at all, on a case-to-case basis subject to existing laws, rules, regulations, executive orders and issuances, and administrative orders governing land use conversion; 3) in case of conversion, the land owners will pay the Department the amount equivalent to the government's investment cost including inflation.

SEC. 10. *Preparation of Land Use and Zoning Ordinance.* - Within one (1) year from the finalization of the SAFDZ, in every city and municipality, all cities and municipalities shall have prepared their respective land use and zoning ordinance incorporating the SAFDZ, where applicable. Thereafter, all land use plans and zoning ordinances shall be updated every four (4) years or as often as may be deemed necessary upon the recommendation of the Housing and Land Use Regulatory Board and must be completed within the first year of the term of office of the mayor. If the cities/municipalities fail to comply with the preparation of zoning and land use plans, the DILG shall impose the penalty as provided for under Republic Act No.7160

SEC. 11. *Penalty for Agricultural Inactivity and Premature Conversion.* - Any person or juridical entity who knowingly or deliberately causes any irrigated agricultural lands seven (7) hectares or larger, whether contiguous or not, within the protected areas for agricultural development, as specified under Section 6 in relation to Section 9 of this Act, to lie idle and unproductive for a period exceeding one (1) year, unless due to force majeure, shall be subject to an idle land tax of Three Thousand Pesos (P3,000.00) per hectare per year. In addition, the violator, shall be required to put back such lands to productive agricultural use. Should the continued agricultural inactivity, unless due to force majeure, exceed a period of two (2) years, the land shall be subject to escheat proceedings.

Any person found guilty of premature or illegal conversion shall be penalized with imprisonment of two (2) to six (6) years, or a fine equivalent to one hundred percent (100%) of the government's investment cost, or both, at the discretion of the court, and an accessory penalty of forfeiture of the land and any improvement thereon.

In addition, the DAR may impose the following penalties, after determining, in an administrative proceedings, that violation of this law has been committed:

- a. Consolation or withdrawal of the authorization for land use conversion; and
- b. Backlisting, or automatic disapproval of pending and subsequent conversion applications that they may file with the DAR.

SEC. 12. *Protection of Watershed Areas.* - All watersheds that are sources of water for existing and potential irrigable areas and recharge areas of major aquifers identified by the Department of Agriculture and the Department of Environment and Natural resources shall be preserves as such at all times.

Chapter 2

Agriculture and Fisheries Modernization Plan

SEC. 13. *Agriculture and Fisheries Modernization Plan (AFMP).* - The Department, in consultation with the farmers and fisher folk, the private sector, NGOs, people's organizations and the appropriate government agencies and offices, shall formulate and implement a medium- and long-term comprehensive Agriculture and Fisheries Modernization Plan.

The Agriculture and Fisheries Modernization Plan shall focus on five (5) major concerns:

- a. Food security;**
- b. Poverty alleviation and social equity;**
- c. Income enhancement and profitability, especially for farmers and fisher folk;**
- d. Global competitiveness; and**
- e. Sustainability.**

SEC. 14. *Food Security, Poverty Alleviation, Social Equity and Income Enhancement.* - The Department, in coordination with other concerned departments or agencies, shall formulate medium- and long-term plans addressing food security, poverty alleviation, social equity and income enhancement concerns based on, but not limited to, the following goals and indicators for development:

- a. Increased income and profit of small farmers and fisherfolk;**
- b. Availability of rice and other staple foods at affordable process;**
- c. Reduction of rural poverty and income inequality;**
- d. Reduction of the incidence of malnutrition;**
- e. Reduction of rural unemployment and underemployment; and**
- f. Improvement in land tenure of small farmers.**

SEC. 15. *Global Competitiveness and Sustainability.* - The Department shall formulate medium-and-long-term plans aimed at enhancing the global competitiveness and sustainability of the country in agriculture and fisheries based on, but not limited to, the following goals and indicators for development:

- a. Increase in the volume, quality and value of agriculture and fisheries production for domestic consumption and for exports;**
- b. Reduction in post-harvest losses;**
- c. Increase in the number/types and quality of processed agricultural and fishery products;**
- d. Increase in the number of international trading partners in agriculture and fishery products;**

e. Increase in the number of sustainable agriculture and fisheries firms engaged in domestic production, processing, marketing and export activities;

f. Increase in and wider level of entrepreneurship among farmers and fisher folk in the area;

g. Increase in the number of farms engaged in diversified farming; and

h. Reduced use of agro-chemicals that are harmful to health and the environment.

SEC. 16. *Global Climate Change.* - The Department, in coordination with the Philippine Atmospheric, Geophysical and Astronomical Service Administration (P. A. G. A. S. A.) and such other appropriate government agencies, shall devise a method of regularly monitoring and considering the effect of global climate changes, weather disturbances, and annual productivity cycles for the purpose of forecasting and formulating agriculture and fisheries production programs.

SEC. 17. *Special Concerns.* - The Department shall consider the following areas of concerns, among other in formulating the AFMP:

a. Strategies and programs aimed to achieve growth and profitability targets in the context of the constraints and challenges of the World Trade Organization (WTO);

b. Programs arising from the implementation of the Agrarian Reform Program;

c. Identification of SAFDZ;

d. Infrastructure and market support for the SAFDZ;

e. Infrastructure support to make agriculture and fisheries production inputs, information and technology readily available to farmers, fisherfolk, cooperatives and entrepreneurs;

f. Credit programs for small farmers and fisher folk, and agricultural graduates;

g. Comprehensive and integrated agriculture and fisheries research, development and extension services;

h. Preservation of biodiversity, genetic materials and the environment;

i. Adequate and timely response against environmental threats to agriculture and fisheries;

j. Rural non-farm employment;

k. Access to aquatic resources by fisher folk;

l. Basic needs program for the impoverished sectors of society who will be affected by liberalization;

m. Indigenous peoples;

n. Rural youth;

o. Women;

p. Handicapped persons; and

q. Senior citizens.

SEC. 18. *Monitoring and Evaluation.* - The Department shall develop the capability of monitoring the AFMP through a Program Benefit Monitoring and Evaluation System (PBMES). In addition, it can secure the services of independent consultants and external evaluators in order to assess its over-all impact. The Department shall make periodic reports to the Congressional Oversight Committee on Agriculture and Fisheries Modernization.

SEC. 19. *Role of Other Agencies.* - All units and agencies of the government shall support the Department in the implementation of the AFMP.

In particular, the Department of Public Works and Highways shall coordinate with the Department with respect to the infrastructure support aspect of the plan order to accomplish networking of related infrastructure facilities.

The Department of Interior and Local Government shall provide assistance to the Department in mobilizing resources under the control of local government units.

The Department of Trade and Industry, Agrarian Reform, Science and Technology, and Environment and Natural Resources shall coordinate their investment programs and activities to complement the Department's implementation of the AFMP.

The Department of Education, Culture and Sports, the Technical Educational and Skills Development Authority, the Department of Health with the Department of Social Services and Development shall coordinate with the Department to determine the financial requirements of small farmers and fisherfolk to adjust to the effects of modernization as envisioned in the Agriculture and Fisheries Modernization Plan.

The departments referred above shall be required to identify in their budget proposals the allocation intended for the improvement of the environmental and other conditions affecting agriculture and fisheries.

Congressional initiatives shall also be coordinated by the Committees on Agriculture on both Houses to complement and enhance the programs and activities of the Department in the implementation of the AFMP.

Chapter 3

Credit

SEC.20. *Declaration of Policy.* - It is hereby declared the policy of the State to alleviate poverty and promote vigorous growth in the countryside through access to credit by small farmers, fisher folk, particularly the women involved in the production, processing and trading of agriculture and fisheries products and the small and medium scale enterprises (SMEs) and industries engaged in agriculture and fisheries.

Interest rates shall be determined by market forces, provided that existing credit arrangements with agrarian reform beneficiaries are not affected. Emphasis of the program shall be on proper management and utilization.

In this regard, the State enjoins the active participation of the banking sector and government financial institutions in the rural financial system.

SEC. 21. *Phase-out of the Directed Credit Programs (DCPs) and Provision for the Agro-Industry Modernization Credit and Financing Program (AMCFP).* - The Department shall implement existing DCPs; however, the Department shall, within a period of four (4) years from the effectivity of this Act, phase-out all DCPs and deposit all its loanable funds including those under the Comprehensive Agricultural Loan Fund (CALF) including new funds provided by this Act for the AMCFP and transfer the management thereof to cooperative banks, rural banks, government financial institutions and viable NGOs for the Agro-Industry Modernization Credit Financing Program (AMCFP). Interest earnings of the said deposited loan funds shall be reverted to the AMCFP.

SEC.22. *Coverage.* - An agriculture, fisheries and agrarian reform credit and financing system shall be designed for the use and benefit of farmers, fisher folk those engaged in food and non-food production, processing and trading, cooperatives, farmers'/fisherfolk's organization, and SMEs engaged in agriculture hereinafter referred to in this chapter as the "beneficiaries"

SEC. 23. *Scope of the Agro-Industry Modernization Credit and Financing Program (AMCFP).* - The Agro-Industry Modernization Credit and Financing Program shall include the packaging and delivery of various credit assistance programs for the following:

- a. Agriculture and fisheries production including possessing of fisheries and agri-based products and farm inputs;**
- b. Acquisition of work animals, farm and fishery equipment and machinery;**
- c. Acquisition of seeds, fertilizer, poultry, livestock, feeds and other similar items;**
- d. Procurement of agriculture and fisheries products for storage, trading, processing and distribution;**
- e. Acquisition of water pumps and installation of tube wells for irrigation;**
- f. Construction, acquisition and repair of facilities for production, processing, storage, transportation, communication, marketing and such other facilities in support of agriculture and fisheries;**
- g. Working capital for agriculture and fisheries graduates to enable them to engage in agriculture and fisheries related economic activities;**
- h. Agribusiness activities which support soil and water conservation and ecology-enhancing activities;**
- i. Privately-funded and LGU-funded irrigation systems that are designed to protect the watershed;**
- j. Working capital for long-gestating projects; and**
- k. Credit guarantees on uncollateralized loans to farmers and fisherfolks.**

SEC. 24. *Review of the mandates of Land Bank of the Philippines Crop Insurance Corporation, Guarantee Fund For Small and Medium Enterprises, Quedan and Rural Credit Guarantee Corporation, Agricultural Credit Policy Council.* - The Department of Finance shall commission an independent review of the charters and the respective programs of the Land Bank of the Philippines (LBP),

Philippine Crop Insurance Corporation (PCIC), Guarantee Fund for Small and Medium Enterprises (GFSME), Quedan and Rural Credit Guarantee Corporation (Quendancor), and Agricultural Credit Policy Council (ACPC), and recommend policy changes and other measures to induce the private sectors participation in lending to agriculture and to improve credit access by farmers and fisherfolk: Provided, That agriculture and fisheries projects with long gestation period shall be entitled to a longer grace period in repaying the loan based on the economic life of the project.

The Land Bank of the Philippines, shall, in accordance with its original mandate, focus primarily on plans and programs in relation to the financing of agrarian reform and the delivery of credit services to the agriculture and fisheries sectors, especially to small farmers and fisherfolk.

The review shall start six (6) months after the enactment of this Act. Thereafter, the review shall make recommendations to the appropriate Congressional Committees for possible legislative actions and to the Executive Branch for policy and program changes within six (6) months after submission.

SEC. 25. *Rationalization of Credit Guarantee Schemes and Funds.* - All existing credit guarantee schemes and funds applicable to the agriculture and fishery sectors shall be rationalized and consolidated into an Agriculture and Fisheries Credit Guarantee Fund. The rationalization shall cover the credit guarantee schemes and funds operated by the Quendancor, the GFSME and the Comprehensive Agricultural Loan Fund. The Agriculture and Fisheries Credit Guarantee Fund shall be managed and implemented by the Quendancor Provided, That representation to the Quendancor Board shall be granted to cooperatives, local government units and rural financial institutions; Provided, further, That credit guarantee shall be given only to small-scale agriculture and fisheries activities and to countryside micro-small, and medium enterprises. It may also cover loan guarantees for purchase orders and sales contracts.

The Agriculture and Fisheries Credit Guarantee Fund shall be funded by at least ten percent (10%) of the funding allocation for the AMCFP.

Chapter 4

Irrigation

SEC. 26. *Declaration of Policy.* - It is the policy of the State to use its natural resources rationally and equitably. The state shall prevent the further destruction of watersheds, rehabilitate existing irrigation systems and promote the development of irrigation systems that are effective, affordable, appropriate, and efficient.

In the choice of location-specific irrigation projects, the economic principle of comparative advantage shall always be adhered to.

SEC. 27. *Research and Development.* - Irrigation Research and Development (R&D) shall be pursued and priority shall be given to the development of effective, appropriate , and efficient irrigation and water management technologies.

The Department shall coordinate with the Department of Environment and Natural Resources concerning the preservation and rehabilitation of watersheds to support the irrigation systems.

SEC. 28. *Criteria for Selection of Irrigation Development Scheme.* - The Selection of appropriate scheme of irrigation development shall be location-specific and based on the following criteria:

a. Technical feasibility;

- b. Cost-effectiveness;
- c. Affordability, low investment cost per unit area;
- d. Sustainability and simplicity of operation;
- e. Recovery of operation and maintenance cost;
- f. Efficiency in water use;
- g. Length of gestation period; and
- h. Potential for increasing unit area productivity.

All irrigation projects shall, in addition to the criteria enumerated above, be subjected to a social cost-benefit analysis.

SEC. 29. *Simplified Public Bidding.* - The construction, repair, rehabilitation, improvement, or maintenance of irrigation projects and facilities shall follow the Commission on Audit (COA) rules on simplified public bidding.

Irrigation projects undertaken by farmers, farmer's organizations and other private entities whose funding is partly or wholly acquired by way of loan from government financial institutions shall not be subject to the bidding requirements of the government.

SEC. 30. *National Irrigation Systems (NIS).* - The National Irrigation Administration (NIA) shall continue to plan, design, develop, rehabilitate, and improve the NISs. It shall continue to maintain and operate the major irrigation structures including the head works and main canals.

In addition, the NIA is mandated to gradually turn over operation and maintenance of the National Irrigation System's secondary canals and on-farm facilities to Irrigators' Associations

SEC. 31. *Communal Irrigation Systems (CIS).* - The Department shall, within five (5) years from the effectivity of this Act, devolve the planning, design and management of CISs, including the transfer of NIA's assets and resources in relation to the CIS, to the LGUs. The budget for the development, construction, operation and maintenance of the CIS and other types of irrigation systems shall be prepared by and coursed through the LGUs. The NIA shall continue to provide technical assistance to the LGUs even after complete devolution of the Irrigation Systems to the LGUs, as may be deemed necessary.

SEC. 32. *Minor Irrigation Schemes.* - The Department shall formulate and develop a plan for the promotion of a private sector-led development of minor irrigation systems, such as Shallow Tube Wells (STWs), Low-Lift pumps (LLPs) and other inundation systems. the plan shall be included in the Short-term Agriculture and fisheries Modernization Plan.

SEC. 33. *Other Irrigation Construction Schemes.* - The Government shall also encourage the construction of irrigation facilities through other viable schemes for the construction of irrigation such as build-operate-transfer, build-transfer and other schemes that will fast-track the development of irrigation systems.

SEC. 34. *Guarantee of the National Government.* - To make build-operate-transfer (BOT) projects for irrigation attractive to proponents, the national government shall issue the need payment guarantee

for BOT projects which shall answer for default of the National Irrigation Administration. Such amounts needed to answer for the payment guarantee is hereby to be appropriated.

SEC. 35. *Irrigation Service Fees (ISF).* - Upon effectivity of this Act, the NIA shall immediately review the ISF rates and recommend to the Department reasonable rates within six (6) months from the effectivity of this Act.

SEC. 36. *Monitoring and Evaluation.* - The Department shall monitor the implementation of R&D programs and irrigation projects. The Department shall review all existing irrigation systems every four (4) years, to determine their viability or ineffectiveness. The Department shall employ the services of independent evaluators to assess the overall impact of the country's irrigation development .

SEC. 37. *Exemption from Election Ban.* - The repair, maintenance and rehabilitation of irrigation facilities as well as BOT irrigation projects shall be exempted from the scope of the election ban on public works.

Chapter 5

Information and Marketing Support Service

SEC. 38. *Declaration of Policy.* - It is hereby declared the policy of the State to empower Filipino farmers and fisherfolk, particularly the women, involved in agriculture and fisheries through the provision of timely, accurate and responsive business information and efficient trading services which will link them to profitable markets for their products. They shall likewise be given innovative support toward the generation of maximum income through assistance in marketing.

SEC. 39. *Coverage.* - A market information system shall be installed for the use and benefit of, but not limited to, the farmers and fisher folk, cooperatives, traders, processors, the LGUs and the Department.

SEC. 40. *The Marketing Assistance System.* - The Department shall establish a National Marketing Assistance Program that will immediately lead to the creation of a national marketing umbrella in order to ensure the generation of the highest possible income for the farmers and fisher folk or groups of farmers and fisher folk, matching supply and demand in both domestic and foreign markets.

SEC. 41. *National Information Network.* - A National Information Network (NIN) shall be set up from the Department level down to the regional, provincial and municipal offices within one (1) year from the approval of this Act taking into account existing information networks and seems.

The NIN shall likewise link the various research institutions for easy access to data on agriculture and fisheries research and technology. All departments, agencies, bureaus, research institutions, and local government units shall consolidate and continuously update all relevant information and data on a periodic basis and make such data available on the Internet.

SEC. 42. *Information and Marketing Service.* - The NIN shall provide information and marketing services related to agriculture and fisheries which shall include the following:

a. Supply data;

b. Demand data

c. Price and Price trends;

d. Product standards for both fresh and processed agricultural and fisheries projects;

e. Directory of, but not limited to cooperatives, traders, key market centers, processors and business institutions concerned with agriculture and fisheries at the provincial and municipal levels;

f. Research information and technology generated from research institutions involved in agriculture and fisheries;

g. International, regional and local market forecasts; and

h. Resource accounting data.

SEC. 43. *Initial Set-up.* - The Department shall provide technical assistance in setting -up the NIN at the local level through the cooperatives and the LGUs Provided , That , at the local level, a system that will make marketing information and services related to agriculture and fisheries will be readily available in the city/municipal public market for the benefit of the producers, traders and consumers.

SEC. 44. *Role of Government Agencies.* - The Bureau of Agricultural Statistics will serve as the central information server and will provide technical assistance to end-users in accessing and analyzing product and market information and technology.

The Department of Transportation and Communications shall provide technical and infrastructure assistance to the Department in setting up the NIN.

LGUs shall coordinate with the Department for technical assistance in order to accelerate the establishment and training of information end-users in their respective jurisdictions.

The Cooperative Development Authority shall coordinate with the Department for technical assistance in order to provide training assistance to cooperatives in the use of market information and technology.

SEC. 45. *Role of Private Sector-* The NIN shall likewise be accessible to the private sector engaged in agriculture and fisheries enterprises. The Department shall formulate guidelines and determine fees for private sector entities that use the NIN.

Chapter 6

Other Infrastructure

SEC. 46. *Agriculture and Fisheries Infrastructure Support Services.* - The Department of Public Works and Highways , the Department of Transportation and Communications, the Department of Trade and Industry and the LGUs shall coordinate with the Department to address the infrastructure requirements in accordance with this Act Provided, that The Department and the LGU shall also strengthen its agricultural engineering support in carrying out the smooth and expeditious implementation of agricultural infrastructure projects.

SEC. 47. *Criteria for Prioritization.* - The prioritization of government resources for rural infrastructure shall be based on the following criteria:

- a. Agro-industrial potential of the area;
- b. Socio-economic contributions of the investments in the area;
- c. Absence of public investments in the area; and
- d. Presence of agrarian reform beneficiaries and other small farmers and fisher folk in the area.

SEC. 48. *Public Infrastructure Facilities.* - Public Infrastructure investments shall give preference to the kind , type and model of infrastructure facilities that are cost-effective and will be useful for the production, conservation, and distribution of most commodities and should benefit the most number of agriculture and fisheries producers and processors.

SEC. 49. *Private Infrastructure Facilities.* - For infrastructure facilities primarily benefiting private investors, the State shall facilitate the purchase and use of such utilities and shall keep to the minimum the bureaucratic requirements for these types of investments. Private investors include cooperatives or corporations of agriculture and fisheries producers and processors.

SEC. 50. *Public Works Act.* - The Department of Public Works and Highways shall coordinate with the Department for the purpose of determining the order of priorities for public works funded under the Public Works Act directly or indirectly affect agriculture and fisheries.

SEC. 51. *Fishports, Seaports and Airports.* - The Department of Transportation and Communications, Philippine Ports Authority and Philippine Fisheries Development Authority shall coordinate with the Department for the purpose of determining priority fishports, seaports and airports and facilitating the installation of bulk-handling and storage facilities , and other post-harvest facilities needed to enhance the marketing of agriculture and fisheries products Provided, that fishports , seaports an airports are also equipped with quarantine , sanitary and phytosanitary centers. The Department of Transportation and Communications (DOTC) shall have the mandate to cancel arrastre and cargo handling franchises among operators whom it deems inefficient and/or ineffective owing, but not limited to, a past history of under-capitalization, lack of equipment and lack of professional expertise. The DOTC shall recommend to the Philippine Ports Authority and consult with ship-owners and ship-operators in assessing the cargo-handling capabilities of cargo operators prior to extending new franchises or awards.

SEC. 52. *Farm-to-Market Roads.* - The Department shall coordinate with the LGUs and the resident-farmers and fisher folk in order to identify priority locations of farm-to -market roads that take into account the number of farmer and fisher folk and their families who shall benefit therefrom and the amount , kind and importance of agricultural and fisheries products produced in the area.

Construction of farm-to-market roads shall be a priority investment of the LGUs which shall provide a counterpart of not less than ten percent (10%) of the project cost subject to their IRA in the area.

SEC. 53. *Rural Energy.* - The Department shall coordinate with the Department of Energy (DOE), the Department of Public Works and Highways (DPWH), the National Electrification Administration (NEA) and the National Power Corporation (NAPOCOR) for the identification and installation of appropriate types of energy sources particularly in the use of non-conventional energy sources for the locality in order to enhance agriculture and fisheries development in the area.

SEC. 54. *Communications Infrastructure.* - The Department shall coordinate with the DOTC to facilitate the installation of telecommunication facilities in priority areas, in order to enhance agriculture and fisheries development .

SEC. 55. *Water Supply System.* - the Department shall coordinate with the DPWH and the LGUs for the identification and installation of water supply system in the locality for agro-industrial uses to enhance agriculture and fisheries development in the area.

SEC. 56. *Research and Technology Infrastructure.* - The Department in coordination with other government agencies shall give priority and facilitate the funding of infrastructure necessary for research ventures such as farm laboratories and demonstration farms with state colleges and universities that derive their core funds from the Department .

SEC. 57. *Post-Harvest Facilities.* - The Department shall coordinate with the Bureau of Post-Harvest for Research and Extension and the Post-harvest Horticulture, Training and Research Center of the University of the Philippines, Los Baños, to identify appropriate post-harvest facilities and technology needed to enhance agriculture and fisheries development in the area.

SEC. 58. *Public Market and Abattoirs.* - The Department shall encourage the LGUs to turn over the management and supervision of public markets and abattoirs to market vendors' cooperatives and for that purpose, the appropriation for post-harvest facilities shall include the support for market vendor' facilities.

The Department shall coordinate with the LGUs in the establishment of standardized market systems and use of sanitary market , facilities , and abattoirs, intended to ensure the food safety and quality.

All markets shall have a sanitation unit, proper and adequate drainage and sewerage system, ample water supply, public toilets with lavatories, garbage receptacles, ice plants and cold storage, adequate lighting and ventilation and supply of electricity to ensure cleanliness and sanitation. Price monitoring bulletin boards for selected commodities and weighing scales accessible to the public shall also be established.

Proper protection and preservation of agriculture and fisheries products being sold in the market shall also be observed. All foods which require no further cooking shall be wrapped , covered , or enclosed in containers to preserve the freshness and prevent contamination. Selling of products on market floors shall be prohibited.

SEC. 59. *Agricultural Machinery.* - The Department shall give priority to the development and promotion of appropriate agricultural machinery and other agricultural mechanization technologies to enhance agricultural mechanization in the countryside.

Chapter 7

Products Standardization and Consumer Safety

SEC. 60. *Declaration of Policy.* - It is the policy of the State that all sectors involved in the production, processing, distribution and marketing of food and non-food agricultural and fisheries products shall adhere to, and implement the use of product standards in order to ensure consumer safety and promote the competitiveness of agriculture and fisheries products.

SEC. 61. *Bureau of Agriculture and Fisheries Product Standards.* - The Department, within six (6) months after the approval of this act, and in consultation with the Department of Trade and Industry and the Bureau of Food and Drug, shall establish the Bureau of Agriculture and Fisheries Product Standards (BAFPS).

SEC. 62. *Coverage.* - The BAFPS shall set and implement standards for fresh, primary-and - secondary-processed agricultural and fishery products.

SEC. 63. *Powers and Functions.* - The BAFPS shall have the following powers and functions:

- a. Formulate and enforce standards of quality in the processing, preservation, packaging, labeling, importation, exportation, distribution, and advertising of agricultural and fisheries products;
- b. Conduct research on product standardization, alignment of the local standards with the international standards; and
- c. Conduct regular inspection of processing plants, storage facilities, abattoirs, as well as public and private markets in order to ensure freshness, safety and quality of products.

SEC. 64. *Pool of Experts and Advisers.* - The BAFPS may coordinate, seek the services of, and consult with both private and governmental agencies, research institute, educational establishments and such other individuals and entities with expertise in the field of product standards and consumer safety.

The Department of Trade and Industry, the Food and Nutrition Research Institute, and the Bureau of Food and Drug Administration shall provide technical advice and form part of the pool of experts/advisers of the BAFPS.

TITLE 2

HUMAN RESOURCE DEVELOPMENT

SEC. 65. *Declaration of Policy.* - It is hereby declared the policy of the State to give priority to education and training on science and technology in order to accelerate social progress and promote total human liberation and development.

The State shall promote industrialization and full employment, based on sound agriculture and fisheries development and agrarian reform, through industries that make full and efficient use of human and natural resources.

SEC. 66. *National Agriculture and Fisheries Education System (NAFES).* - The Commission on Higher Education (CHED), in coordination with the Department and appropriate government agencies, shall establish a National Agriculture and Fisheries Education System (NAFES) which shall have the following objectives:

- a. To establish, maintain and support a complete and integrated system of agriculture and fisheries education relevant to the needs of the economy, the community and society.
- b. To modernize and rationalize agriculture and fisheries education from the elementary to the tertiary levels;
- c. To unify, coordinate and improve the system of implementation of academic programs that are geared toward achieving agriculture and fisheries development in the country; and
- d. To upgrade the quality , ensure sustainability and promote the global competitiveness, at all levels, of agriculture and fisheries education.

SEC. 67. *Education Program for Elementary and Secondary Levels.* - There is hereby established an Agriculture and Fisheries Education Program, under the NAFES specially designed for elementary and secondary levels. The program shall be formulated, organized and implemented by the DECS with the following objectives:

- a. to develop appropriate values that form the foundation for sustained growth in agriculture and fisheries modernization.
- b. to increase the attractiveness of agriculture and fisheries education, so that more young and talented person will look at agriculture and fisheries as an acceptable option for career and livelihood;
- c. to promote appreciation of science in agriculture and fisheries development;
- d. to develop among students, positive attitudes towards entrepreneurship and global competition in the agriculture and fisheries business;
- e. to improve the present curriculum in the elementary and secondary levels by emphasizing the core values necessary for agriculture and fisheries modernization; and
- f. to develop an outreach program where students, parents and schools become instruments in effecting positive changes in the pupil's home and community.

SEC. 68. *Post-Secondary Education Program.* - There is hereby established a Post-Secondary Education Program for Agriculture and Fisheries under the NAFES, which shall be formulated and developed by TESDA in coordination with the appropriate government agencies and the private sector. The program shall include, among others, the following:

- a. a mechanism for a flexible process of curriculum development;
- b. integration of the dual training system in the various agricultural curricula and training programs;
- c. integration of entrepreneurship and global competitiveness in the agro-fisheries curricula;
- d. institutionalizing agriculture and fisheries skills standards and technical testing and certification;
- e. regular upgrading of learning/training facilities, school buildings , laboratory equipment; and
- f. development of a system for the strict enforcement of school regulations regarding standards and requirements.

SEC. 69. *Network of National Centers of Excellence for Territory Education.* - There is hereby established a Network of National Centers of Excellence in Agriculture and Fisheries Education, composed of qualified public and private colleges and universities, duly accredited as National Centers of Excellence (NCE) in the field of agriculture and fisheries.

For this purpose, the CHED shall formulate and implement a system of accreditation Provided, That not more than one provincial institute in every province and no more than one national university in each field in every region shall be accredited as such and Provided, further, That the system shall be based on the following criteria:

- a. institutional accessibility, population, economic contribution of agriculture and fisheries in the community, and the needs or unique requirements of the area
- b. quantity and quality of research studies conducted;
- c. degree of utilization of research results;
- d. quantity and quality of faculty members;
- e. type of facilities;
- f. linkage with international organizations; and
- g. potential contribution to agriculture and fisheries development in the target area.

SEC. 70. *Rationalization Plan.* - For the purpose of upgrading and maintaining a high degree of academic excellence in the fields of agriculture and fisheries, all existing public and private colleges and universities that are not hereinafter designated and accredited as centers of excellence shall be given adequate time to redirect its program to non-agriculture and/or non-fisheries areas needed by the province or region and/or merge their program with accredited NCEs in accordance with the Rationalization Plan to be jointly formulated by CHED and the Philippine Association of State Universities and Colleges (PASUC) upon consultation with the institution concerned.

The Rationalization Plan shall include a policy for the effective utilization of affected personnel and facilities, and shall not be construed as to result in the decrease of the budget allocation for the state universities and colleges concerned.

SEC. 71. *Counterpart Funding from LGUs.* - The LGUs shall, within two, (2) years from the effectivity of this Act, provide at least ten percent (10%) of the Maintenance and Other Operating Expenses (MOOE) budget for the operation of the provincial institutes within their area of responsibility.

In consultation with the LGUs, the CHED shall develop a provincial-national partnership scheme for a reasonable sharing of financial support taking into account social equity factors for poor provinces.

SEC. 72. *National Integrated Human Resource Development Plan in Agriculture and Fisheries.* - The CHED, in coordination with the Department and appropriate government agencies, shall formulate, develop and implement an integrated human resource development plan in agriculture and fisheries which shall serve as an instrument that will provide over-all direction in setting priorities in curricular programs, enrollment, performance targets, and investment programs.

SEC. 73. *Output-Oriented Performance Standards.* - In order to ensure the institutional accountability, efficiency, and quality, there shall be formulated and developed an Output-Oriented Performance Standards which shall serve as the primary instrument for institutional evaluation.

For this purpose, all public and private universities and colleges, that are designated as centers of excellence, shall cause to be installed a computerized monitoring and evaluation system that periodically collects and regularly measures variables indicating institutional performance based on the Output-Oriented Performance Standards.

SEC. 74. *Evaluation System.* - Not later than one (1) year from the effectivity of this Act, the CHED shall establish a baseline information using the Output-Oriented Performance Standards referred to

in Section 73 of this Title. Once every five (5) years thereafter, all designated NCEs in agriculture and fisheries shall be subject to a third party evaluation.

The evaluation shall include, among others, management and educational experts of national stature and representatives of key sectors of the agriculture and fisheries industries, as well as representatives of the Department, the Department of Environment and Natural Resources, the Department of Science and Technology, and the National Economic and Development Authority.

SEC. 75. *Agriculture and Fisheries Board.* - There shall be created an Agriculture and Fisheries Board in the Professional Regulation Commission to upgrade the Agriculture and Fisheries profession.

Those who have not passed the Civil Service Examination for Fisheries and Agriculture but have served the industry in either private or public capacity for not less than five (5) years shall be automatically granted eligibility by the Board of Examiners.

The first board of examination for B.S. Fisheries and/or Agriculture Graduates shall be conducted within one (1) year from the approval of this Act.

SEC. 76. *Continuing Agriculture and Fisheries Education Program.* - The Commission on Higher Education, the Department of Education, Culture and Sports and Technical Education and Skills Development Authority, in coordination with the Department and the public and private universities and colleges, shall formulate and develop a National and Integrated Continuing Agriculture and Fisheries Education Program, which shall address the current education and training requirements of teachers, professors and educators in agriculture and fisheries.

For this purpose, pre-service and in-service training of teachers in Home Economics Livelihood Education (HELE) for the primary level and Technology and Home Economics (THE) for the Secondary level, shall be upgraded.

SEC. 77. *Scholarship Program.* - The CHED in coordination with the public and private universities and colleges, TESDA and the DBM, shall develop a national scholarship program that provides opportunities for deserving academic staff to pursue advanced degrees in agriculture and fisheries. Where appropriate, such scholarship program shall also provide opportunities for graduate work in foreign universities.

SEC. 78. *Merit System.* - To promote the development of scientific excellence and academic scholarship, the public and private universities and colleges, in cooperation with the CHED and the DBM, shall institute an output- oriented unified system of promotion for the academic personnel.

SEC. 79. *Budgetary Allocation Scheme.* - The Budgetary Allocation Scheme for NAFES shall be as follows:

a. The current appropriation or budgets of state universities and colleges, that are herein designate as NCEs, shall continue and shall be modified and adjusted in succeeding years in order to meet the standards of the rationalized programs of the institutions as approved by Congress and shall be included in the annual General Appropriations Act;

b. NCEs that are created under this Act shall likewise be provided with budgetary support based on their programs and a new staffing pattern as approved by DBM and shall be included in the annual General Appropriations Act.

RESEARCH DEVELOPMENT AND EXTENSION

Chapter 1

Research and Development

SEC. 80. *Declaration of Policy.* - It is hereby declared the policy of the State to promote science and technology as essential for national development and progress.

The State shall likewise give priority to research and development, invention, innovation, and their utilization and to science and technology education, training, and services. In addition to appropriate and relevant technology, the state shall support indigenous and self-reliant scientific and technological capabilities, and their application to the country's productive system and national life.

SEC. 81. *The National Research and Development System in Agriculture and Fisheries.* - The Department, in coordination with the Department of Science and Technology and other appropriate agencies and research institutions shall enhance, support and consolidate the existing National Research and Development System in Agriculture and Fisheries within six (6) months from the approval of this Act. Provided, That fisheries research and development shall be pursued separately, from but in close coordination with that of agriculture.

SEC. 82. *Special Concerns in Agriculture and Fisheries Research Services.* - Agriculture and Fisheries Research and Development activities shall be multidisciplinary and shall involve farmers, fisherfolk and their organizations, and those engaged in food and non-food production and processing including the private and public sectors.

Research institutions and centers shall enjoy autonomy and academic freedom. The Department, in collaboration with the Department of Science and Technology and other appropriate agencies, shall harmonize its merit and output-oriented promotion system governing the scientific community in order to promote increased research excellence and productivity and provide the government research system a competitive edge in retaining its scientific personnel.

Appropriate technology shall be used to protect the environment, reduce cost of production , improve product quality and increase value added for global competitiveness.

SEC. 83. *Funds for Research and Development.* - Considering the nature of research, development and extension activities, funding shall be based on the following guidelines:

- a. Allocation of multi-year budgets which shall be treated as research and development grants.
- b. The budget for agriculture and fisheries research and development shall be at least one percent (1%) of the gross value added (GVA) by year 2001 allocating at least one percent (1%) of the total amount by 1999. The Department of Finance (DOF) in consultation with the Department shall formulate revenue enhancement measures to fund this facility.
- c. At least twenty percent (20%) shall be spent in support of basic research and not more than eighty percent (80%) shall be used for applied research and technology packaging and transfer activities.
- d. A science fund shall be established from which the scientific community in agriculture and fisheries shall draw its financial resource for sustained career development, Provide, That only the interest earnings of the funds shall be used.

The Department and other research agencies, in the national interest, are encouraged to go into co-financing agreements with the private sector in the conduct of research and development provided that the terms and conditions of the agreement are beneficial to the country.

SEC. 84. *Excellence and Accountability in Research and Development.* - The Department, in collaboration with the Department of Science and Technology and other appropriate government agencies, shall formulate the national guidelines in evaluating research and development activities and institutions, which shall involve an independent and interdisciplinary team of collegial reviewer and evaluators.

SEC. 85. *Communication of Research Results and Research-Extension Linkage.* - Research information and technology shall be communicated through the National Information Network (NIN)

All government agencies including the state colleges and universities and private educational institutions selected as NCEs shall be computerized , networked , provided with regular updated information and shall likewise provide, through the NIN results of research and development activities and current available technology relating agriculture and fisheries.

Chapter 2

Extension Services

SEC. 86. *Declaration of Policy.* - It is hereby declared the policy of the State to promote science and technology as essential for national development and progress. The State shall give priority for the utilization of research results through formal and non-formal education, extension, and training services. It shall support the development of a national extension system that will help accelerate the transformation of Philippine agriculture and fisheries from a resource -based to a technology-based industry.

SEC. 87. *Extension Services.* - Agriculture and Fisheries extension services shall cover the following major services to the farming and fishing community:

- a. Training services;
- b. Farm or business advisory services;
- c. Demonstration services; and
- d. Information and communication support services through trimedia.

SEC. 88. *Special Concerns in the Delivery of Extension services.* - The delivery of agriculture and Fisheries Extension Services shall be multidisciplinary and shall involve the farmers, fisherfolk, and their organizations and those engaged in food and non-food production and processing, including the private and public sectors.

There shall be a national merit and promotion system governing all extension personnel, regardless of source of funding, to promote professionalism and achieve excellence and productivity in the provision of the government extension services.

SEC. 89. *The National Extension System for Agriculture and Fisheries (NESAF).* - The Department in coordination with the appropriate government agencies, shall formulate a National Extension System for Agriculture and Fisheries.

The National Extension System for Agriculture and Fisheries shall be composed of three (3) subsystems:

- a. the national government subsystem which directly complements;**
- b. The local government subsystems; and**
- c. the private sector subsystem.**

SEC. 90. *The Role of Local Government Units.* - The LGUs shall be responsible for delivering direct agriculture and fisheries extension services.

The provincial governments shall integrate the operations for the agriculture extension services and shall undertake an annual evaluation of all municipal extension programs.

The extension program of state colleges and universities shall primarily focus on the improvement of the capability of the LGU extension service by providing:

- a) Degree and non-degree training programs;**
- b) Technical assistance;**
- c) Extension cum research activities;**
- d) Monitoring and evaluation of LGU extension projects; and**
- e) Information support services through the tri-media and electronics.**

SEC. 91. *Role of the Private Sector in Extension.* - The department shall encourage the participation of farmers and fisherfolk cooperatives and associations and others in the private sector in the training and other complementary extension services especially in community organizing, use of participatory approaches, popularization of training materials, regenerative agricultural technologies, agri-business and management skills.

The Department is hereby authorized to commission and provide funding for such training and extension services undertaken by the private sector.

SEC. 92. *The Role of Government Agencies.* - The Department, together with state colleges and universities shall assist in the LGU's extension system by improving their effectiveness and efficiency through capability-building and complementary extension activities such as:

- a) technical assistance;**
- b) training of LGU extension personnel;**
- c) improvement of physical facilities;**
- d) extension cum research; and**
- e) information support services;**

SEC. 93. *Funding for Extension Activities.* - Extension activities shall be supported by the following measures:

- a) allocation of multi-year budgets that shall be treated as grants;
- b) allow transfer of funds from the Department to the local government units as extension grants, and
- c) the budget for agriculture and fisheries extension services shall be at least one percent (1%) of the gross value added (GVA) by year 2001

SEC.94. *Excellence and Accountability in Extension.* - The Department shall formulate the guidelines in evaluating extension, activities, and institutions, which shall involve an independent and interdisciplinary team of the collegial reviewers and evaluators.

SEC.95. *Extension Communication Support for LGU's.* - The Department in coordination with the public and private universities and colleges, shall develop an integrated multimedia support for national and LGU extension programs. The Department shall assist the LGU's in the computerization of communication support services to clients and linkages to the NIN.

TITLE 4

RURAL NON-FARM EMPLOYMENT

Chapter 1

SEC. 96. *Declaration of policy.* - It is hereby declared the policy of the State to promote full employment. Economic history, however, shows that as an economy modernizes the number of workers employed in its agricultural sector declines. It is therefore necessary to formulate policies and implement programs that will employ workers efficiently in rural areas in order to improve their standard of living, and reduce their propensity to migrate to urban areas.

SEC. 97. *Objectives.* - Rural non-farm employment aims to:

- a) promote a basic needs approach to rural development;
- b) make rural workers more adaptable and flexible through education and training;
- c) promote rural industrialization and the establishment of agro- processing enterprises in rural communities; and
- d) increase the income of rural workers.

Chapter 2

The Basic Needs Program

SEC. 98. *Principles.* - The Department, in coordination with the appropriate government agencies, shall formulate the Basic Needs Program to create employment and cushion the effect of liberalization based on the following principles:

- a) No credit subsidies shall be granted. The normal rules of banking shall apply to all enterprises involved, provided that existing credit arrangements with ARBs shall not be affected.
- b) Enterprises can use training, information, advisory and related services of the Government free of charge.
- c) The participation of the private sector shall be voluntary.

Teams composed of specialists from government agencies and the private sectors shall develop pilot programs in selected locales to establish the planning, implementation and evaluation procedures.

SEC. 99. *Participation of Government Agencies.* - The replication of the program shall be the responsibility of the local government units concerned in collaboration with the appropriate government agencies, and the private sector. The local government units shall bear the costs of promoting and monitoring the basic needs program for which their IRA shall be increased accordingly as recommended by the Secretary of the Department Provided, That the appropriate national government agencies shall continue to provide the necessary technical as well as financial assistance to the LGUs in the replication of the program.

The Cooperatives Development Authority shall encourage the establishment and growth of associations and cooperatives as vehicles for the stable expansion of basic needs enterprises.

The Department of Education, Culture and Sports, Department of Health, and the Technical Education and Skills Development Authority shall coordinate with the Department and Congress in the review, rationalization and reallocation of their regular budgets as well as their budgets under the GATT- related measures fund to finance education, training, health and other welfare services for farmers and fisherfolk.

Chapter 3

Rural Industrialization

Industry Dispersal Program

SEC. 100. *Principles.* - Rural industrialization and industry dispersal programs shall be based on the interplay of market forces. The Board of Investments (BOI) is hereby required to give the highest priority to the grant of incentives to business and industries with linkages to agriculture.

SEC. 101. *Role of Government Agencies.* - The appropriate government agencies, under the leadership of the LGUs concerned, shall provide integrated services and information to prospective enterprises under the one-stop-shop concept.

Local government units are authorized to undertake investment and marketing missions provided that the costs of such missions are borne by the LGUs concerned. In making their land use plans, the LGUs, in consultation with the appropriate government agencies concerned, shall identify areas for industrial parks.

The Department shall coordinate with the Department of Trade and Industry , in particular, the Board of Investments, in the formulation of investments priorities for rural areas.

The Regional Wage Boards shall consult participating enterprises in this program before they issue wage orders.

SEC. 102. *Participating Enterprises.* - Participating enterprises may request any government agency for training, technical and advisory services free of cost.

A set of incentives shall be given to enterprises that subcontract part of their production to farmers, fisherfolk and landless workers during periods when they are not engaged in agricultural activities.

SEC. 103. *Financing.* - Except for basic infrastructure and other goods that benefit all citizens, the facilities of this program should be undertaken and financed by the private sector.

Chapter 4

Training of Workers

SEC. 104. *Role of TESDA.* - TESDA shall organize local committees that will advise on the scope, nature and duration of training for the above-mentioned programs.

TESDA is authorized to request the additional budgetary resources for these programs: Provided, That after a reasonable period, the task of coordinating the training is transferred to the LGUs concerned.

SEC. 105. *Role of the DENR.* - The Department and the DENR shall organize the training of workers in coastal resources management and sustainable fishing techniques.

SEC. 106. *Role of the Technology and Livelihood Resource Center (TLRC).* - The TLRC shall undertake field training in entrepreneurship and management of workers involved in the basic needs program.

SEC. 107. *Special Training Projects for Women.* - The Department, in collaboration with the appropriate government agencies concerned shall plan and implement special training projects for women for absorption in the basic needs and rural industrialization programs.

TITLE 5

TRADE AND FISCAL INCENTIVES

SEC. 108. Taxation policies must not deter the growth of value-adding activities in the rural areas.

SEC. 109. All enterprises engaged in agriculture and fisheries as duly certified by the Department in consultation with the Department of Finance and the board of Investment, shall, for five (5) years after the effectivity of this Act, be exempted from the payment of tariff and duties for the importation of all types of agriculture and fisheries inputs, equipment and machinery such as, but not limited to, fertilizer, insecticide, pesticide, tractor, trailers, trucks, farm implements and machinery, harvesters, threshers, hybrid seeds, genetic materials, sprayers, packaging machinery and materials, bulk-handling facilities such as conveyors and mini loaders, weighing scales, harvesting equipment, spare parts of all agricultural equipment, fishing equipment and parts thereof, refrigeration equipment, and renewable energy systems such as solar panels *Provided, however,* That the imported agricultural and fishery inputs, equipment and machinery shall be for the exclusive use of the importing enterprise.

The Department, in consultation with the Department of Finance and the Board of Investment, shall, within ninety (90) days from the effectivity of this Act, formulate the implementing rules and regulations governing the importation of agriculture and fishery inputs, equipment and machinery.

SEC. 110. Any person, partnership, corporation, association and other juridical entity found circumventing the provisions of Section 109 of this Act shall suffer the penalty of imprisonment for a period of not less than six (6) months but not more than one (1) year, or a fine equivalent to two hundred percent (200%) of the value of the imported materials, or both, at the discretion of the court, and the accessory penalties of confiscation of the imported goods in favor of the government and revocation of the privileges given under this title.

In cases where the violator is a juridical entity, the officers responsible in the violation of Section 109 shall suffer the penalty of imprisonment prescribed in this Section.

The importation of goods equivalent to or exceeding the declared assets of the enterprise, partnership, or the authorized capital stock in case of corporations, and/or the resale of the imported goods shall be a prima facie evidence of the violation of the provisions of Section 109 of this Act.

GENERAL PROVISIONS

SEC. 111. *Initial Appropriation.* - For the first year of implementation of this Act, the amount of Twenty Billion pesos (P20,000,000,000.00) is hereby appropriated. The Department is hereby authorized to re-align its appropriations in the current year of the date of effectivity of this Act to conform with the requirements of this Act Provided, That the amount shall be allocated and disbursed as follows:

1. Thirty percent (30%) for irrigation;
2. Ten percent (10%) for post-harvest facilities Provided, That the Secretary of Agriculture may invest up to fifty percent (50%) of the said amount to fund post-harvest facilities of cooperatives, especially market vendors' cooperatives, where said cooperatives exist and are operational Provided, further, That if no cooperatives are operational, said amount shall fund the post-harvest facilities of the market -assistance system;
3. Ten percent (10%) for other infrastructure including fishports, seaports, and airports, farm-and -coast-to-market roads, rural energy, communications infrastructure, watershed rehabilitation, water supply system, research and technology infrastructure, public markets and abattoirs;
4. Ten percent (10%) for the Agro-industry Modernization Credit and Financing Program (AMCFP) to be deposited by the Department in participating rural-based public and private financial institutions provided that no less than fifty percent (50%) of said funds shall be deposited in rural banks in cooperative banks;
5. Eight percent (8%) for the implementation of the Farmer-Fisherfolk Marketing Assistance System and support of market vendors' cooperatives;
6. Ten percent (10%) for research and development, four percent (4%) of which shall be used to support the Biotechnology Program;
7. Five percent (5%) for capability-building of farmers and fisherfolk organizations and LGUs for the effective implementation of the agriculture and fisheries programs at the local level;
8. Six percent (6%) for salary supplement of Extension Workers under the LGUs;
9. Five percent (5%) for NAFES , for the upgrading of the facilities of State Universities and Colleges that will be chosen as national center of excellence in agriculture and fisheries education;

10. Four percent (4%) for the National Information Network (NIN) consisting of both the national and local levels;

11. One-and-three-fourth percent (1.75%) for SUC- and TESDA-administered Rural Non-Farm Employment Training; and

12. One-fourth percent (0.25%) for the identification of the SAFDZs.

SEC. 112. *Continuing Appropriation.* - The Department of Budget and Management (DBM) is hereby mandated to include annually in the next six (6) years, in the President's Program of expenditures for submission to Congress, and release, an amount not less than Seventeen billion pesos (P17,000,000,000.00) for the implementation of this Act.

Additional funds over and above the regular yearly budget of the Department shall be sourced from twenty percent (20%) of the proceeds of the securitization of government assets, including the Subic, Clark, and other special economic zones.

Other sources of funds shall be from the following:

a. Fifty Percent (50%) of the net earnings of the Public Estates Authority;

b. Loans, grants, bequest, or donations, whether from local or foreign sources;

c. Forty percent (40%) of the TESDA Skills Development Fund;

d. Net proceeds from the privatization of the Food Terminal Inc. (FTI), the Bureau of Animal Industry (BAI), the Bureau of Plant Industry (BPI), and other assets of the Department that will be identified by the DA Secretary and recommended to the President for privatization;

e. Proceeds from the Minimum Access Volume (MAV) in accordance with the provisions of Republic Act No. 8178;

f. Poverty alleviation Fund; and

g. Fifty Percent (50%) of the Support Facilities and Services Fund under Republic Act No. 6657.

SEC. 113. *Implementing Rules and Regulations.* - The Secretary within ninety (90) working days after the effectivity of this act, together with the Department of Agrarian Reform (DAR), Department of Environment and Natural Resources (DENR), Department of Finance (DOF), Department of Science and Technology (DOST), Department of Trade and Industry (DTI), Commission on Higher Education (CHED), Technical Education and Skills Development Authority (TESDA), Department of Education, Culture and Sports (DECS), Department of Social Services and Development (DSSD), National Economic and Development Authority (NEDA), Department of Budget and Management (DBM), Department of Labor and Employment (DOLE), Commission on Audit (COA), Civil Service Commission (CSC), in consultation with other agencies concerned, farmers, fisherfolk and agribusiness organizations, and in coordination with the Congressional Oversight committee on Agriculture and Fisheries Modernization, shall promulgate the rules and regulations for the effective implementation of this act.

The Secretary shall submit to the Committee on Agriculture of both houses of congress copies of the implementing rules and regulations within thirty (30) days after their promulgation.

Any violation of this section shall render the official/s concerned liable under Republic Act. No. 6713 otherwise known as the "Code of Conduct and Ethical Standards for Public Officials and Employees" and other existing administrative and/or criminal laws.

SEC. 114. *Congressional Oversight Committee on Agricultural and Fisheries Modernization.* - A congressional Committee on Agricultural and Fisheries Modernization is hereby created to be composed of the Chairs of the Committee on Agriculture of both Houses, six (6) members of the House of Representatives and six (6) members of the Senate, to be designated respectively by the Speaker of the House and the President of the Senate, who shall endeavor to have the various sectors and regions of the country represented.

The Chairs of the Committees on Agriculture in the Senate and House of Representatives, shall be respectively, the Chair and Co-Chair of the Oversight Committee. The other members shall receive no compensation: however, traveling and other necessary expenses shall be allowed.

The Committee shall oversee and monitor the implementation of the Congressional Commission on Agricultural Modernization (AGRICOM) recommendations as well as all programs, projects and activities related to agriculture and fisheries, and its allied concerns in both public and private sectors, with a view to providing all legislative support and assistance within the powers of Congress to ensure their inclusion, wherever feasible, in the national, regional, provincial, municipal, and sectoral development plans to recommend the disposal of assets no longer needed by the Department to fund the modernization program, and to see them through their successful implementation.

SEC. 115. *Powers and Functions of the Committee.* - The Congressional Oversight on Agriculture and Fisheries Modernization shall have the following powers and functions:

- a. Prescribe and adopt guidelines that will govern its work;
- b. Hold hearings, receive testimonies and reports pertinent to its specified concerns;
- c. Secure from any department, bureau, office or instrumentality of the Government such assistance as may be needed, including technical information, preparation, and production of reports and submission of recommendations or plans as it may require;
- d. Summon by subpoena any public or private citizen to testify before it, or require by subpoena duces tecum to produce before it such records, reports or other documents as may be necessary in the performance of its functions;
- e. Use resource persons from the public and private sectors as may be needed;
- f. Carry on the winding-up work of AGRICOM, such as editing and printing all technical reports and studies as well as bibliographic cataloguing of its collection of source materials, continue its information and advocacy work;
- g. Cause to be transferred to the Committee all works, outputs, source materials, and assets, funds, supplies and equipment of AGRICOM;
- h. Approve the budget for the work of the Committee and all disbursements therefrom , including compensation of all personnel;
- i. Organize its staff and hire and appoint such employees and personnel whether temporary , contractual or on consultancy, subject to applicable rules; and

j. Generally to exercise all the powers necessary to attain the purposes for which its created.

SEC. 116. *Periodic Reports.* - The Committee shall submit periodic reports on its findings and make recommendations on actions to be taken by Congress and the appropriate department, and in order to carry out the objectives of this Act, an initial amount of Twenty million pesos (P20,000,000.00) is hereby appropriated for the Oversight Committee for the first year of its operation.

SEC. 117. *Automatic Review.* - Every five (5) years after the effectivity of this Act, an independent review panel composed of experts to be appointed by the President shall review the policies and programs in the Agriculture and Fisheries Modernization Act and shall make recommendations, based on its findings, to the President and to both Houses of Congress.

SEC. 118. *Repealing Clause.* - All laws, decrees, executive issuance, rules and regulations inconsistent with this Act are hereby repealed or modified accordingly.

SEC. 119. *Separability Clause.* - The provisions of this Act are hereby declared to be separable, and in the event one or more of such provisions are held unconstitutional, the validity of the other provisions shall not be affected thereby.

SEC. 120. *Effectivity.* - This Act shall take effect thirty (30) days from the date of its publication in the Official Gazette or in at least two (2) newspapers general circulation.

Approved: 22 December 1997.

**OPERATING POLICIES AND PROCEDURES
(IMPLEMENTING GUIDELINES)
OF THE AGRO-INDUSTRY MODERNIZATION
CREDIT AND FINANCING PROGRAM (AMCFP)**



Agricultural Credit Policy Council



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Part I

**The Agro-Industry Modernization
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THE AGRO-INDUSTRY MODERNIZATION CREDIT AND FINANCING PROGRAM (AMCFP) DESIGN *

I. BACKGROUND

Following reforms instituted in the financial market in the mid-eighties, the government's basic thrust shifted towards a market-led strategy in the allocation and pricing of financial resources from a supply-driven and commodity-specific approach in agricultural lending in the 70s. These reforms, in effect, led to two critical episodes: (1) the lifting of interest rate ceilings on deposits and loans; and (2) the termination of all direct lending programs by government non-financial agencies and the consequent consolidation of 20 agricultural credit programs in the Comprehensive Agricultural Loan Fund (CALF).

Despite attempts at decisive rural financial reforms, however, the government, in response to political and economic pressures, took several steps backward by introducing rural development strategies that again relied heavily on credit assistance through non-financial agencies, either directly or indirectly. This resulted in the implementation of nearly a hundred separate and fragmented directed credit programs (DCPs) as of June 1998, more or less equally shared by the agricultural and non-agricultural sectors.

Their (DCPs') adoption has generally been perceived as the only remaining option to ensure the availability of credit to specific groups/sectors especially in a period of transition. Theoretically, the main justification for introducing DCPs is "market failure" - meaning, the inability of an otherwise competitive (formal) credit system to efficiently and adequately allocate credit (due to market imperfections arising from informational problems, monitoring and enforcement weaknesses and other limitations in the rural sector such as lack of linkages, scarcity of collateral and seasonal or simultaneous risk inherent in agricultural/rural projects).

While it may be easy to predict the imminent failure of DCPs based on lessons gleaned from previous experience, data from recent empirical work (DOF-NCC-CPIP Studies, 1997 and 1998) confirm/validate past findings (TBAC/ACPC Studies) that, indeed, DCPs are generally ineffective, inefficient and therefore, costly and wasteful of scarce government resources. Credit or lending should be limited to banks and in areas where banks are ineffective, to viable private organizations like cooperatives and NGOs. Non-financial government agencies should thus, in principle, give priority attention to more substantive responsibilities including policy development, monitoring and evaluation, enterprise promotion, institutional building, research and extension, among others.

* Prepared jointly by the ACPC and the National Credit Council (NCC) through a series of consultations conducted with implementing agencies, other stakeholders, the financial sector, government and private sectors, and farmers and fisherfolk groups, and approved by the NCC on December 11, 1998 and the ACPC governing council on January 7, 1999.

With this as basic framework, the Agriculture and Fisheries Modernization Act (AFMA) of 1997 or RA 8435 was enacted into law which provides for, among other things, the rationalization of thirty-nine (39) directed credit programs (DCPs) including the CALF within a period of 4 years and the consequent consolidation of loanable funds including new funds for the AMCFP or the Agro-Industry Modernization Credit and Financing Program. This will, in effect, close all credit "pipes" emanating from different sources and open only one through the AMCFP.

The AMCFP is, therefore, seen as the major program through which the state can fulfill its objective of enhancing credit access to the rural poor. More specifically, Section 22 of this Act provides that *"an agriculture, fisheries and agrarian reform credit and financing system shall be designed for the use and benefit of farmers, fisherfolk, those engaged in food and non-food production, processing and trading, cooperatives, farmers/fisherfolk's organizations and small and medium enterprises (SMEs) engaged in agriculture and fisheries"*.

Altogether, thus, the AMCFP is regarded as the dawn of a new setting in rural finance, paving the way for the development of a multi-track, multi-commodity, sector-neutral and basically market-driven scheme to supplant all existing DCPs.

II. THE AMCFP DESIGN

Rationale for the AMCFP

The creation of the AMCFP is clearly stipulated in the AFMA or RA 8435 which states, *"...deposit all loanable funds of phased-out DCPs including those under the CALF, including new funds provided by the Act for the Agro-Industry Modernization Credit and Financing Program or the AMCFP"*. It is, therefore, a serious attempt of the government to minimize distortions or inefficiencies in the rural financial market by terminating DCPs and rationalizing them into one broad government lending scheme (i.e., the AMCFP) while ensuring the continued access of smallholders to financial services.

Program Scope and Objectives

Essentially, the AMCFP aims to establish an efficient, responsive and sustainable credit or financial system for small farmers; fisherfolk; those engaged in food and non-food production, processing and trading; cooperatives; farmers/fisherfolk's organizations; and small and medium scale enterprises (SMEs) engaged in agriculture and fisheries in pursuit of a modernized and self-sufficient agriculture and fisheries sector.¹ Put simply, the AMCFP aims to provide smallholders access to financial services.

¹ See Attachment 1 for the list of agri-related projects to be covered by the AMCFP as specified in the AFMA.

Basic Policy Framework

The design of the AMCFP is anchored on the following principles and considerations:

- That implementation of DCPs by different government non-financial agencies should be a thing of the past;
- That the Department of Agriculture should, over the long run, primarily focus on the monitoring and evaluation of the AMCFP and the provision of appropriate support services including infrastructure, research and extension, training or institution-building, policy development and advocacy and fund-sourcing from donors;
- That lending decisions and/or credit delivery should be limited *only* to banks and strong or viable lending cooperatives and NGOs;
- That lending interest rates should be market-based to allow conduits a sufficient spread and thus, enable them to cover the cost of funds, administrative and inflation cost, and consequently result in their operational efficiency and self-sustainability in the long run.

The AMCFP Structure

Figure 1 illustrates the structure of AMCFP. It constitutes three key players: (1) *The Department of Agriculture as PROGRAM/FUND OWNER*; (2) *The Agricultural Credit Policy Council (ACPC, i.e., the Council) as PROGRAM OVERSIGHT COMMITTEE*; (3) *the Land Bank of the Philippines and Quedan and Rural Credit and Guarantee Corporation (Quedancor) as FUND WHOLESALERS*; and (4) *Private banks including cooperative rural banks, other rural-based banks, viable cooperatives and NGOs as FUND RETAILERS*. The specific roles/ responsibilities of each key player are as follows:

• **1.1 Program/Fund Owner.** The Department of Agriculture (DA) will be designated as the program/fund owner of the AMCFP, given its role as the “guardian” and lead agency of the sector. As program/fund owner:

- Will oversee the inflow of loanable funds from the rationalized DCPs, including loan receivables, into the AMCFP (through a government financial institution as depository bank) and the outflow of these funds through qualified wholesalers;
- Will set the minimum requirements of the program to be outlined in the Memorandum of Agreement between the government and the Fund Wholesalers. These minimum requirements aim to ensure that the needs of the sector are addressed;

- Will monitor and evaluate the use of the funds, during the entire life of the AMCFP, according to the set of minimum requirements and program objectives;
- May initiate changes in the agreements with the AMCFP Fund Wholesalers (GFIs) whenever deemed necessary;
- In coordination with other government agencies, will provide appropriate support services which include infrastructure, research and extension, training or institution-building, policy development and advocacy and fund-sourcing from donors.

1.2 AMCFP Oversight Committee. The AMCFP Oversight Committee will be the ACPC (the Council) which is composed of the following cabinet-level representatives with the DA Secretary as chairman, the BSP Governor as vice-chairman, and the heads of the Department of Finance (DOF), Department of Budget and Management (DBM), and the National Economic and Development Authority (NEDA) as members. Its primary purpose is to oversee the administration of the AMCFP Fund and ensure that the requirements and objectives of the program are being met, hence, providing safeguards to the efficient and adequate flow of funds to intended clients. It will have for its secretariat, the ACPC.

The envisioned roles/responsibilities of ACPC (the Council) are as follows:

- Review periodically and revise, if necessary, the AMCFP Implementing Guidelines;
- Review and approve the annual budget of the AMCFP;
- Approve the AMCFP plan of action including targets and priorities;
- Cause and facilitate the conduct of performance evaluation of the AMCFP, the AMCFP Fund Wholesalers and the AMCFP Fund Retailers;
- Cause and facilitate the conduct of related policy and action research studies to equip itself with empirical trends and findings as a guide in recommending appropriate policy directions; and
- Require the submission of reports from the institutions involved in AMCFP implementation.

1.3 Land Bank and Quedancor as Fund Wholesalers. On the other hand, Land Bank and Quedancor, will perform the following:

- Open and maintain a trust account for the AMCFP Fund and maintain a separate book of account for the Fund;
- Prepare and present to the AMCFP Oversight Committee the AMCFP's annual budget and plan of action;
- Assign management personnel, as it deems necessary, for the day-to-day operations of the AMCFP to ensure its effective and efficient implementation;
- Formulate and adopt specific guidelines and procedures that would govern the accreditation, evaluation of and release of funds to participating private financial institutions (PFIs), provided such guidelines and procedures conform to the overall AMCFP guidelines;
- Undertake and approve the accreditation of PFIs that will act as Fund Retailers of the AMCFP;
- Undertake credit evaluation, approve and effect the release of funds to qualified AMCFP Fund Retailers;
- Impose the corresponding warranted sanctions, penalties and other actions to ensure compliance by Fund Retailers to the terms and conditions of the released funds;
- Approve loan restructuring of accounts in accordance with the existing policies and guidelines of the GFI;
- In behalf of the DA, institute appropriate legal action, including filing of cases in court against defaulting or delinquent borrowers, as may be warranted to protect the interest of the Fund; and
- In behalf of the DA, judiciously invest any unencumbered fund in highly yielding government bonds/securities, of which earnings will revert to the AMCFP Fund;

1.4 Fund Retailers. The Fund Retailers, as stated in the law, will consist of cooperative banks (CRBs), other rural-based banks, and viable non-government organizations (NGOs)/cooperatives. These Fund Retailers will serve as AMCFP lenders to the sub-borrowers or the intended beneficiaries. These funds shall be disbursed in the form of loans from the fund wholesalers to the retailers.

The Fund Retailers shall:

- Take full responsibility over the financial transactions and decisions in channeling the AMCFP funds to the intended clientele/ borrowers;
- Be tasked to screen the potential borrowers according to their set of criteria.

III. INITIAL GUIDING RULES GOVERNING THE AMCFP OPERATIONS

Program Fund Sources

As provided in Section 21 of the AFMA, all loanable funds from agricultural DCPs shall be deposited to the AMCFP. According to the schedule, the phase-out, consolidation, and transfer of funds to the AMCFP shall be undertaken gradually within the four-year period, i.e. up to February 2002 as indicated in the AFMA-IRR.

Upon the AMCFP's commencement, initial operations of the program will be financed by unencumbered funds of the Comprehensive Agricultural Loan Fund (CALF).

Over and above the amount of funds from the phased-out DCPs, the law provides 10% of the P120B fund that the AFMA pledges for "modernization" over the seven-year period 1998-2004. In particular, on an annual basis, these are:

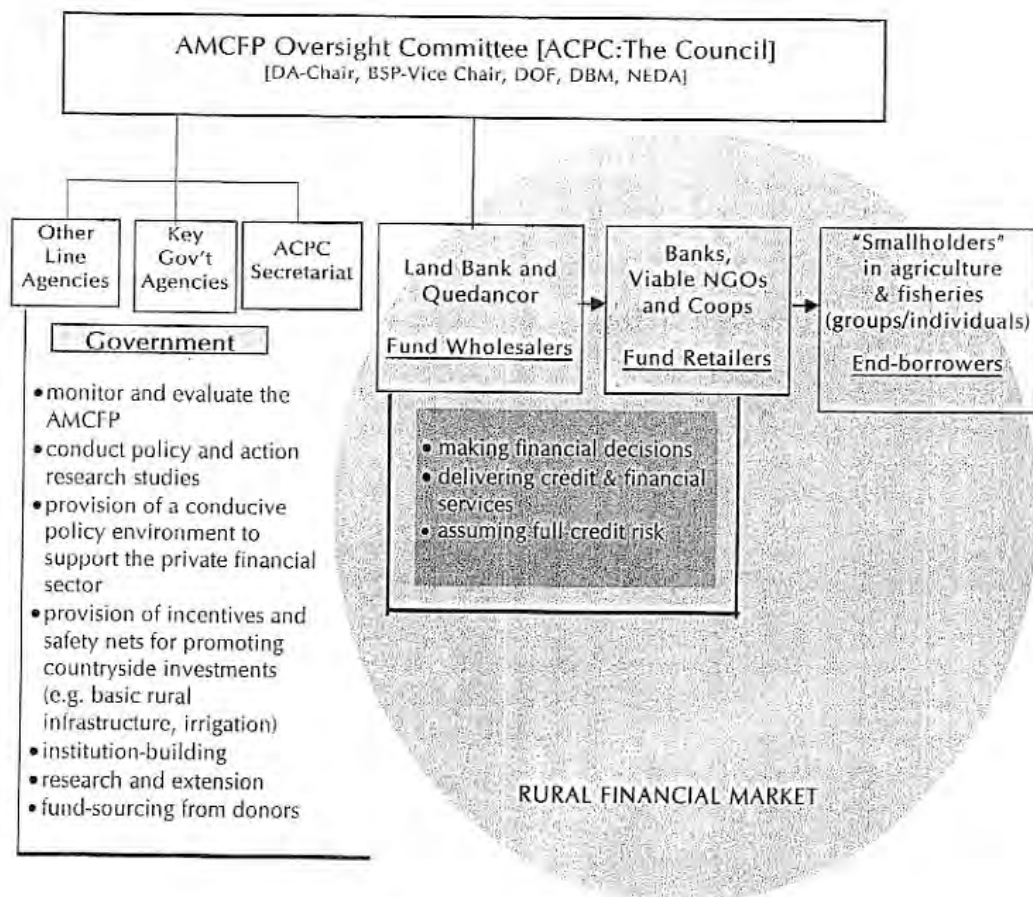
- 10% of the initial fund of P20 B to be allocated for 1998; and
- 10% of the P18B to be allotted annually for the period 1999-2004.

These funds will have to be generated, raised, and included in the General Appropriations Act (GAA). Generation will either involve mobilizing donations and other forms such as privatization of assets.

Setting up/Release of the AMCFP Fund

The AMCFP Fund will be placed in the Fund Wholesalers as a trust account.

Any interest earnings accruing from initially deposited funds shall be plowed back to the AMCFP.



The AMCFP Structure
Figure 1

Interest Rates

Consistent with existing policy, lending rates shall be market-oriented. Upon the program's effectivity, all loans drawn from the AMCFP shall be charged market-determined interest rates. Pass-on rates (from the Fund Wholesalers to Fund Retailers) shall be based on the weighted average interest rate (WAIR) on the 91-day Treasury-bills for short-term loans. The pass-on rates for long-term loans shall be based on the interest on the corresponding notes or bonds issued by the national government.

V. PROGRAM MONITORING AND EVALUATION

The Program Oversight Committee shall review the performance of the AMCFP at least on an annual basis. The evaluation shall be the basis of the DA and the Council for increasing, reducing, suspending, or terminating funding support under the program. The DA and the ACPC Council shall reserve the option to increase, reduce, suspend, or terminate funding support only when the results of monitoring and evaluation conducted by the ACPC warrants such action/s.

Regular monitoring activities and annual performance evaluations shall also be conducted by the ACPC at the program/management and fund manager (wholesaler/retailer) levels. Impact evaluation studies at the end-borrower level shall be conducted to check program outreach. Other policy and action research studies will likewise be conducted to equip the ACPC Secretariat with updated empirical trends/findings to guide them in recommending appropriate policy directions. Findings from these activities shall be presented to the Council to be used as basis for making necessary adjustments in implementation.

Corollarily, participating Fund Retailers and end-borrowers shall provide the ACPC, through its authorized representative(s) access to records, books of accounts, and other documents pertaining to the program.

Part of the interest earnings of the AMCFP Fund shall finance the implementation of these activities.

V. TIMETABLE OF ACTIVITIES

When the AMCFP commences its operations, the timing of pulled-out funds from agricultural DCPs flowing into the program is of crucial importance. The consolidation of funds into the AMCFP should be in perfect synchrony with the rationalization of DCPs in order to avoid major disruptions in the flow of credit to the sector. As mandated in the AFMA, DCPs shall be rationalized and consolidated within a period of four (4) years from the effectivity of RA 8435 or until February 9, 2002.

As per timetable of funds consolidation of agricultural DCP into the AMCFP, the initial core of funds of the AMCFP shall emanate from unencumbered funds of the Comprehensive Agricultural Loan Fund (CALF) together with DA-administered DCPs without legal/administrative impediments.

A more detailed discussion of the complete process of funds transfer of all agricultural DCPs into the AMCFP is found in *Annex 1* entitled "Program for the Rationalization and Funds Transfer of Agricultural DCPs to the AMCFP".

Attachment 1

Coverage of AMCFP
(per RA 8435)

- Agriculture and fisheries production including processing of fisheries and agri-based products and farm inputs;
- Acquisition of work animals, farm and fishery equipment and machinery;
- Acquisition of seeds, fertilizer, poultry, livestock, feeds and other similar items;
- Procurement of agriculture and fisheries products for storage, trading, processing and distribution;
- Acquisition of water pumps and installation of tube wells for irrigation;
- Construction, acquisition and repair of facilities for production, processing, storage, transportation, communication, marketing and such other facilities in support of agriculture and fisheries;
- Working capital for agriculture and fisheries graduates to enable them to engage in agriculture and fisheries-related economic activities;
- Agribusiness activities which support soil and water conservation and ecology-enhancing activities;
- Privately-funded and LGU-funded irrigation systems that are designed to protect the watershed;
- Working capital for long-gestating projects; and
- Credit guarantees on uncollateralized loans to farmers and fisherfolk.

Part II

Operating Policies and Procedures (Implementing Guidelines) of the AMCFP



OPERATING POLICIES AND PROCEDURES
(IMPLEMENTING GUIDELINES) OF THE AMCFP
(AGRO-INDUSTRY MODERNIZATION CREDIT AND FINANCING PROGRAM)

Pursuant to Sections 20, 21, 22 and 23 of Republic Act No. 8435 (Agriculture and Fisheries Modernization Act or AFMA) and its Implementing Rules and Regulations as per Department of Agriculture Administrative Order No. 6 dated July 10, 1998 as amended, the following guidelines governing the administration and utilization of the Agro-Industry Modernization and Financing Program (AMCFP) are hereby promulgated:

1. Basic Policy Principles

These guidelines hereby adopt the basic policy principles espoused under Section 20 of the AFMA and under Executive Order No. 138 (An Executive Order Directing Government Entities involved in the implementation of directed credit programs to adopt the Credit Policy Guidelines of the National Credit Council) dated August 10, 1999 to wit:

- 1.1. Enhancing access to credit by the small farmers, fisherfolk and small and medium scale enterprises engaged in agriculture and fisheries while minimizing distortions or inefficiencies in rural financial intermediation;
- 1.2. Greater role of the private sector in the provision of financial services to the above mentioned sectors;
- 1.3. Adoption of market-oriented interest rates and ensuring recovery of costs of credit delivery to attain sustainability provided existing credit arrangements with agrarian reform beneficiaries are not affected;
- 1.4. Active participation of Government Financial Institutions (GFIs) in the delivery of credit services and non-involvement of Government Non-Financial Institutions (NGFIs) in credit decision making; and
- 1.5. The government to provide enabling policy environment, critical support services and capability-building services that would facilitate increased participation of the private sector in the delivery of credit services.

2. Definition of Terms

- 2.1. "Small farmers and fisherfolk" – refers to natural persons dependent on small-scale subsistence farming or fishing activities as their primary source of income.
- 2.2. "Agri/fishery based small and medium scale enterprises" – refers to the small and medium enterprises (SMEs) engaged in production, processing and trading of agricultural and fishery products. SME shall refer to a business enterprise whose total assets exclusive of the land where the entity's office/plant is located must have the values falling under the following categories:
 - Micro : Not more than P 1,500,000
 - Small : P 1,500,001 to P 15,000,000
 - Medium : P 15,000,001 to P60, 000,000.
- 2.3. "Government Financial Institution (GFI)" – refers to a financial institution in which the government directly or indirectly owns majority of the capital stock and which is supervised by the Bangko Sentral ng Pilipinas.
- 2.4. "Private Financial Institutions (PFIs)" – refers to all private entities with juridical personalities engaged in delivery of financial services (credit, savings or deposits). These shall include: cooperative banks, rural banks, credit cooperatives, multi-purpose cooperatives and people's organizations with lending operations, non-government organizations (NGOs) with micro-credit operations and other private banks.
- 2.5. "End-borrower" – refers to the final borrower of the on-lent or retailed fund who utilizes such fund for economic activities.

3. Program Administration

- 3.1. The Department of Agriculture (DA) shall exercise supervision over the management and utilization of the AMCFP Fund through an AMCFP Oversight Committee. The Agricultural Credit Policy Council (ACPC) shall act as the AMCFP Oversight Committee which shall have the following authorities and functions:

- 3.1.1 Review periodically and revise, if necessary, the AMCFP Implementing Guidelines;
 - 3.1.2 Review and approve the annual budget of the AMCFP;
 - 3.1.3 Approve the AMCFP plan of action including targets and priorities;
 - 3.1.4 Cause and facilitate the conduct of performance evaluation of the AMCFP, the AMCFP Fund Wholesalers, and the AMCFP Fund Retailers;
 - 3.1.5 Cause and facilitate the conduct of related policy and action research studies to equip itself with empirical trends and findings as a guide in recommending appropriate policy directions; and
 - 3.1.6 Require the submission of reports from the institutions involved in AMCFP implementation.
- 3.2. The DA shall appoint Land Bank and Queadancor as AMCFP Fund Wholesalers. In administering the Program, the Fund Wholesalers shall have the following authorities and functions:
- 3.2.1 Open and maintain a trust account for the AMCFP Fund and maintain separate book of account for the Fund;
 - 3.2.2 Prepare and present to the AMCFP Oversight Committee the AMCFP's annual budget and plan of action;
 - 3.2.3 Assign management personnel, as it deems necessary, for the day-to-day operations of the AMCFP to ensure its effective and efficient implementation;
 - 3.2.4 Act as Fund Wholesaler of the AMCFP
 - 3.2.5 Formulate and adopt specific guidelines and procedures that would govern the accreditation, evaluation of and release of funds to Fund Retailers which are participating private financial institutions (PFIs), provided such guidelines and procedures conform to the overall AMCFP guidelines;
 - 3.2.6 Undertake and approve the accreditation of PFIs that will act as Fund Retailers of the AMCFP;
 - 3.2.7 Undertake credit evaluation, approve and effect the release of funds to qualified AMCFP Fund Retailers;

- 3.2.8 Impose the corresponding warranted sanctions, penalties and other actions to ensure compliance by Fund Retailers to the terms and conditions of the released funds;
- 3.2.9 Approve loan restructuring of accounts in accordance with the existing policies and guidelines of the Fund Wholesalers;
- 3.2.10 In behalf of the DA, institute appropriate legal action, including filing of cases in court against defaulting or delinquent borrowers, as may be warranted to protect the interest of the Fund; and
- 3.2.11 In behalf of the DA, judiciously invest any unencumbered fund in high yielding government bonds/securities, of which earnings shall revert to the AMCFP Fund.

4. Program Beneficiaries

The eligible end-borrowers (beneficiaries) of the Program are the following:

- Small farmers and fisherfolk;
- Rural women engaged in production, processing and/or trading of agriculture and fisheries products;
- Agri/fishery based small and medium enterprises (SMEs) provided that if such is a single proprietorship or a partnership, the enterprise is classified as "micro-enterprise" and if such is a cooperative or corporation, majority of its stockholders/members is small farmers and fisherfolk.

5. Financing Schemes

- 5.1 Considering the diverse market characteristics (both of the financial institutions and the target borrowers), the following different financing modes shall be open to qualified retailers:
 - Wholesale loan for relending to qualified beneficiaries;
 - Rediscounting of promissory notes of qualified beneficiaries;
 - Co-financing or loan syndication;
 - Co-financing co-guarantee mode.

- 5.2. The Fund Wholesalers shall develop the specific terms and conditions of the above financing modes with an end view of avoiding duplication with its existing financing facilities as well as design innovative schemes that would promote credit access of the targeted beneficiaries and promote competitiveness of farmers/fisherfolk. The co-financing co-guarantee mode however shall only be open for lending to non-collateralized loans of small farmers/fisherfolk. A Technical Review Team to be composed of representatives from the ACPC and the Fund Wholesalers shall be constituted by the DA Secretary and the Fund Wholesalers' Chief Executive Officer who shall review the design of the specific financing schemes that shall be adopted by the GFI for the Program. The Review Team shall be chaired by the ACPC Executive Director.

6. Eligible Projects

- 6.1. Eligible projects that can be financed using AMCFP funds shall be those listed under Section 23 of AFMA. These are:
- Agriculture and fisheries production including processing of fisheries and agri-based products and farm inputs;
 - Acquisition of work animals, farm and fishery equipment and machinery;
 - Acquisition of seeds, fertilizer, poultry, livestock, feeds and other similar items;
 - Procurement of agriculture and fisheries products for storage, processing and distribution;
 - Acquisition of water pumps and installation of tube wells for irrigation;
 - Construction, acquisition and repair of facilities for production, storage, transportation, communication, marketing and such other facilities in support of agriculture and fisheries;
 - Working capital for agriculture and fisheries graduates to enable them to engage in agriculture and fisheries related economic activities;
 - Agribusiness activities which support soil and water conservation and ecology enhancing activities;

8. Interest Rates

8.1. Interest Rates to Fund Retailers. The Land Bank and Quedancor shall charge interest rates to the Fund Retailers, regardless of financing mode adopted, as follows:

- For short term loans – 91-day Treasury Bill Weighted Average Interest Rate (WAIR) plus spread;
- For term loans - WAIR on government bonds/securities of equivalent maturity plus spread for fixed rate or if a variable rate is adopted, the loan will be repriced quarterly equivalent to the 91 day Treasury Bill WAIR plus spread.

The spread shall be set by the Land Bank and Quedancor taking into account the associated risk which shall range from one percent (1%) per annum for secured notes/loans and two percent (2%) for unsecured notes/loans.

8.2. Interest Rate to End-Borrowers. The Fund Retailers may charge interest rate according to its existing policies, which takes into consideration recovery of its total lending costs and associated credit risk. However, to promote efficiency and discourage “excessive” charging, the Technical Review Team shall recommend an interest rate spread for participating PFIs for adoption in the lending guidelines and shall be reviewed periodically based on the actual spread/interest rates charged by the PFIs.

9. Monitoring and Evaluation

9.1. The ACPC Secretariat shall be responsible for the installation and conduct of program benefit monitoring and evaluation. The ACPC Secretariat shall render a periodic monitoring report highlighting Program’s accomplishments and beneficiary outreach to the Oversight Committee. It shall conduct or cause the conduct of impact evaluation of the Program. It shall likewise undertake or cause the conduct of related policy and action research studies to enable the ACPC Secretariat equip itself with empirical trends and findings as a guide in recommending appropriate policy directions. Based on its monitoring and research findings, the Secretariat shall make recommendations, as to design and policy revisions, including the designation of another GFI or replacement of existing one, if warranted, to the Oversight Committee.

In support of the conduct of related policy research studies, the ACPC Secretariat may propose for approval of the AMCFP Oversight Committee a research budget not covered under its regular budgetary appropriation which shall be charged against the earnings of the AMCFP Fund. The approved budget shall be transferred to and disbursed by the ACPC subject to the usual government accounting and auditing rules and regulations.

- 9.2. The Land Bank and Quedancor designated as Fund Wholesalers shall be responsible for the monitoring of the Fund Retailers and ensure their compliance to the lending terms and conditions, in particular that AMCFP funds are utilized for the approved purpose, specifically, to the targeted end-borrowers. The Land Bank and Quedancor shall require the participating Fund Retailers to render a quarterly monitoring report as to their financial condition and loan utilization using monitoring formats as may be prescribed by the ACPC Secretariat. The Land Bank and Quedancor shall render a consolidated quarterly and annual monitoring report for information of the DA Secretary, GFI Chief Executive Officer and the Oversight Committee.

10. Amendments

These guidelines may be amended or revised by the AMCFP Oversight Committee through a resolution.

11. Effectivity

These guidelines shall take effect on this 20th day of June, 2001. It is understood that all other provisions contained in the original AMCFP Operating Policies and Procedures dated July 26, 1999 not affected herein shall remain unchanged and shall continue to be valid and enforceable.



RESOLUTION NO. 02, Series of 2001*

Approval of the revised Agro-Industry Modernization Credit and Financing Program (AMCFP) Design and Implementing Guidelines with the inclusion of Quedan and Rural Credit Guarantee Corporation (Quedancor) as one of the wholesalers subject to its compliance with the following conditions:

1. Registration with the Bangko Sentral ng Pilipinas as a Non-Bank Government Financial Institution (NBGFI);
2. It shall design and develop measures to ensure that it will not guarantee AMCFP loans and thereby make sure that government funds are not exposed to the same risk twice and, moreover, that fund outreach is maximized by having a different set of clients each for credit and guarantee facilities;
3. Strict and close monitoring by the Oversight Committee of the utilization of the AMCFP Fund.
4. It shall only wholesale (and not retail) AMCFP Funds.

* As contained in the Council-approved minutes of the 15th ACPC Meeting held on June 20, 2001.



RESOLUTION NO. 99-11

II. Approving the AMCFP Operating Policies and Procedures

IT IS HEREBY RESOLVED by the Chairman of the Agricultural Credit Policy Council and its members, that the documented Agro-Industry Modernization Credit and Financing Program (AMCFP) Operating Policies and Procedures will serve as ACPC's guide in selecting qualified wholesalers of the program fund and in defining the terms and conditions of the wholesale loan.

IT IS RESOLVED, further, that the wholesalers will select their retailers as well as set their own lending policies which, however, should be guided by the AMCFP indicative requirements for retailing funds.

IT IS RESOLVED, finally, that crop insurance and credit guarantee be strengthened as support mechanisms/assistance to lessen the risks involved in lending to the agriculture and fisheries sectors, and technical assistance be built-in into the AMCFP to enhance the capabilities of smallholders in order for them to be bankable. Attached is the AMCFP Operating Policies and Procedures document.

Done in Makati City, this 26th day of July, in the Year of our Lord, Nineteen Hundred and Ninety-nine.

Secretary **FELIPE M. MEDALLA**
National Economic Development Authority

Secretary **BENJAMIN E. DIOKNO**
Department of Budget and Management

Secretary **EDGARDO B. ESPIRITU**
Department of Finance

Governor **RAFAEL B. BUENAVENTURA**
Bangko Sentral ng Pilipinas and Vice-Chair,
Agricultural Credit Policy Council

Secretary **EDGARDO J. ANGARA**
Department of Agriculture and
Chairman, Agricultural Credit Policy Council

Office of the President
of the Philippines
Malacañang

and instructions please.

8/21/99

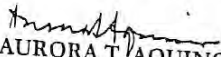
Manila, August 19, 1999

The Honorable
SECRETARY EDGARDO B. ESPIRITU
Department of Finance and Chairman,
National Credit Council
Manila

Sir:

I have the honor to transmit herewith, for your information and guidance, a certified copy of Executive Order No. 138 dated August 10, 1999 entitled "DIRECTING GOVERNMENT ENTITIES INVOLVED IN THE IMPLEMENTATION OF CREDIT PROGRAMS TO ADOPT THE CREDIT POLICY GUIDELINES FORMULATED BY THE NATIONAL CREDIT COUNCIL."

Very truly yours,
For the Executive Secretary:


AURORA T. AQUINO
Director IV

MALACAÑANG
MANILA
BY THE PRESIDENT OF THE PHILIPPINES

EXECUTIVE ORDER NO. 138

**DIRECTING GOVERNMENT ENTITIES INVOLVED IN THE
IMPLEMENTATION OF CREDIT PROGRAMS TO ADOPT THE
CREDIT POLICY GUIDELINES FORMULATED BY THE
NATIONAL CREDIT COUNCIL**

WHEREAS, the government puts priority on the alleviation of poverty in the country;

WHEREAS, greater access to financial services is considered one of the important components in improving the living conditions of the disadvantaged sectors of the economy;

WHEREAS, there are a number of government-funded credit programs that are inefficiently managed and implemented, resulting in huge inefficiencies and waste of scarce government resources;

WHEREAS, the basic sector still lacks access to credit services despite the proliferation of several directed credit programs implemented by government line agencies;

WHEREAS, in 1994, Administrative Order No. 86 mandated the National Credit Council (NCC) to rationalize directed credit programs with the government providing a supportive and appropriate policy environment and institutional framework towards a viable and sustainable financial market;

WHEREAS, directed credit programs refer to those programs implemented by the government which are funded out of budgetary allocation, special funds from the government, loans or grants from donor agencies and are lent out at subsidized interest rates;

WHEREAS, the government will continue to pursue a liberalized and market-oriented economy where the private sector plays a major role and the government provides the enabling environment for the efficient functioning of markets and the participation of the private sector;

WHEREAS, this policy is explicitly espoused in the recently enacted Agriculture and Fisheries Modernization Act and the Social Reform and Poverty Alleviation Act;



PJEE Hologram # 6781

- Use of internally generated funds and savings deposits as source of loanable funds will be given priority.
- Appropriate regulatory and prudential standards will be enforced to promote the use of small savings instruments, particularly in the rural areas.

Interest Rate

- Interest rates charged for government credit programs should not be lower than the prevailing market rates.
- The recovery of financial and operational costs of the wholesale/retail financial conduit should be a paramount consideration in interest rate setting.

SEC. 3. The following guidelines will also be adopted and used by the various institutions involved in the delivery of credit services:

a. National Government Non-Financial Agencies (GNFAs) and Government-Owned and Controlled Corporations (GOCCs)

1. GNFA's will focus on the provision and facilitation of critical services such as basic rural infrastructure (e.g. rural roads, farm to market roads, irrigation services, etc.), human and organizational infrastructure to make rural-and-urban based on micro-enterprises profitable.
2. GNFA's and GOCC's in partnership with appropriate private sector institutions will focus on the provision of capability building services (e.g. education and training, operation of information centers, etc.) to those institutions in the delivery of credit services to the basic sector.
3. GNFA's and GOCC's will no longer be engaged in providing credit services directly or indirectly to various sectors. Funds of existing credit programs being implemented by GNFA's will be channeled through GFIs. GNFA's will work closely with GFIs in identifying the broad target clientele. The credit decision will be with the GFIs.
4. GNFA's and GOCC's are directed to immediately start the rationalization of directed credit programs that they are currently implementing in accordance with the rationalization program of the National Credit Council.



- Use of internally generated funds and savings deposits as source of loanable funds will be given priority.
- Appropriate regulatory and prudential standards will be enforced to promote the use of small savings instruments, particularly in the rural areas.

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a. National Government Non-Financial Agencies (GNFAs) and Government-Owned and Controlled Corporations (GOCCs)

1. GNFAs will focus on the provision and facilitation of critical services such as basic rural infrastructure (e.g. rural roads, farm to market roads, irrigation services, etc.), human and organizational infrastructure to make rural-and-urban based on micro-enterprises profitable.
2. GNFAs and GOCCs in partnership with appropriate private sector institutions will focus on the provision of capability building services (e.g. education and training, operation of information centers, etc.) to those institutions in the delivery of credit services to the basic sector.
3. GNFAs and GOCCs will no longer be engaged in providing credit services directly or indirectly to various sectors. Funds of existing credit programs being implemented by GNFAs will be channeled through GFIs. GNFAs will work closely with GFIs in identifying the broad target clientele. The credit decision will be with the GFIs.
4. GNFAs and GOCCs are directed to immediately start the rationalization of directed credit programs that they are currently implementing in accordance with the rationalization program of the National Credit Council.



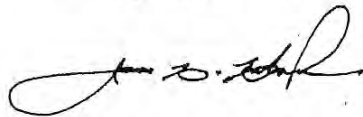
SEC. 4. The National Credit Council is hereby directed to formulate the operating guidelines of this Executive Order in consultation with the concerned agencies of the government, and implement a rationalization program for Directed Credit Programs using the policy guidelines in this Executive Order. In view of this, the Department of Budget and Management (DBM) is directed to coordinate with the National Credit Council before budgetary funds for the implementation of Credit Programs by GNFA's and GOCCs are released.

SEC. 5. All government financial and non-financial agencies are directed to adopt these policy guidelines.

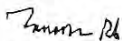
SEC. 6. The government directed credit programs to be covered by this executive order include those but not limited to the list shown in Annex 1 of this Executive Order.

SEC. 7. This Executive Order shall take effect immediately.

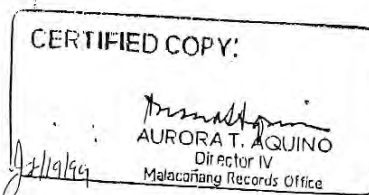
DONE in the City of Manila, this 10TH day of August in the year of Our Lord, nineteen hundred and ninety nine.



By the President:



RONALDO B. ZAMORA
Executive Secretary





OPERATING GUIDELINES OF EO 138

(Directing Government Entities involved in the implementation of
Credit Programs to adopt the Credit Policy Guidelines
Formulated by the National Credit Council)

Pursuant to Section 4 of Executive Order No. 138 dated 10 August 1999, the following operating guidelines are hereby promulgated to implement the credit policy guidelines adopted by the National Credit Council (NCC):

1. Rationale

This Executive Order implements current government policy to pursue a liberalized and market-oriented economy where the private sector plays a major role and the government provides the enabling environment for the efficient functioning of markets and the participation of the private sector. This EO also implements government's directive under AO 86 issued in 1994 to rationalize directed credit programs in all sectors of the economy. The AO created and mandated the National Credit Council (NCC), an inter-agency body, to implement the directive.

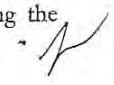
In 1997, Congress likewise formulated measures that support the implementation of this policy – the Agriculture and Fisheries Modernization Act (AFMA) and Social Reform and Poverty Alleviation Act. These laws espoused the implementation of market-based financial and credit policies and the establishment of a viable and sustainable financial market. The AFMA in particular provides for the phase-out of directed credit programs in the agriculture sector over a four-year period.

2. Basic Policy Principles

- 2.1 Greater role of the private sector in the provision of financial services to the basic sector, as defined under RA 8425, the Anti-Poverty and Social Reform Act;
- 2.2 Adoption of market-oriented financial and credit policies, (e.g. market-oriented interest rates on loans and deposits) by leveling the playing field to encourage a competitive credit environment;

- 2.3 Government to provide an enabling policy environment, critical support services and capability-building services that will facilitate the increased participation of the private sector in the delivery of credit services;
- 2.4 Non-participation of Government Non-Financial Agencies (GNFAs) and Government-Owned and -Controlled Corporations (GOCCs) in the implementation of credit programs.

3. Definition of Terms

- 3.1 Government non-financial agencies (GNFAs) – these refer to all government departments and line agencies involved in the delivery of basic support and infrastructure services to clients of specific sectors (e.g. Department of Agriculture, Department of Trade and Industry etc.).
 - 3.2 Government financial institutions (GFIs) - are those financial institutions in which the government directly or indirectly owns majority of the capital stock and which are either registered with or directly supervised by the Bangko Sentral ng Pilipinas.
 - 3.3 Government-owned and controlled corporations (GOCCs) - these are corporations, which are created by special law or organized under the Corporation Code in which the government, directly or indirectly, has majority ownership of the capital stock.
 - 3.4 Private financial institutions (PFIs) - include all private entities engaged in the delivery of financial services to the basic sector. These include rural banks, thrift banks, micro-credit NGOs, credit cooperatives, multi-purpose cooperatives with lending operations, people's organizations and other private banks.
 - 3.5 Directed Credit Programs (DCPs) - as defined in Executive Order No. 138, directed credit programs refer to those programs implemented by the government which are funded out of budgetary allocation, special funds from the government, loans or grants from donor agencies, and are lent out at subsidized interest rates.
 - 3.6 Market-oriented Interest Rates - this is defined as the prevailing 91-day Treasury Bill weighted average interest rate. Financial institutions engaged in lending should consider the recovery of financial and operational costs of wholesale/retail lending in interest rate setting. The 91-day T-Bill will be used as the benchmark rate in determining the market interest rates.
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
4. Coverage of the Executive Order

These guidelines shall cover all directed credit programs (DCPs) implemented by government non-financial agencies (GNFAs), government financial institutions (GFIs) and government-owned and controlled corporations (GOCCs). In the case of agri-related credit programs, the design of the Agriculture Modernization Credit and Financing Program (AMCFP) jointly formulated and approved by the Agricultural Credit and Policy Council (ACPC) and the National Credit Council (NCC) and the operating guidelines approved by the ACPC shall apply. Said guidelines should adopt the policy principles espoused in the Agriculture Fisheries and Modernization Act (AFMA).

5. DCP Rationalization Program

- 5.1 The DCP rationalization program mentioned in Section 3.a.4 of the Executive Order refers to the phase-out of GNFA involvement in the delivery of credit services and the transfer of this function to GFIs. This program shall follow the DCP phase-out period (up to end-February 2002) in the agriculture sector as mandated under the Agriculture and Fisheries Modernization Act (AFMA).
- 5.2 GNFA's and GOCCs will no longer initiate new DCPs starting year 2000. Should there be any, on-going DCPs implemented by GNFA's and GOCCs will be phased-out by February 2002. GOCCs that are authorized by their own charters to undertake lending activities, can continue their lending programs/projects, provided that such are funded from their internally generated funds. Such lending programs/projects should neither draw funding from national government appropriations nor from loans guaranteed by the national government.
- 5.3 Funds of existing DCPs being implemented by GNFA's and GOCCs will be transferred to the GFIs of their choice. The implementation of credit programs is described in section 7.0 below.
- 5.4 The shift towards market rates will be done upon transfer of DCPs from GNFA's to GFIs. Terms and conditions of individual loan contracts between the borrowers and GNFA's/GOCCs concerned, prior to the transfer, shall prevail until loan maturity.

6. Mechanics for the phase-out of credit programs from line agencies

- 6.1 All credit programs covered by the Executive Order will be audited to determine the loans outstanding and the remaining balances of each of the credit programs. The DOF/NCC in coordination with the Department of Budget and Management (DBM) and the Commission on Audit (COA), shall take all the necessary appropriate measures to implement this provision immediately upon approval of these guidelines.
 - 6.2 Auditing and accounting of funds will include but not be limited to the following:
 - 6.2.1 Total amount of funding for the DCP (initial fund and additional allocation)
 - 6.2.2 Outstanding fund balances
 - 6.2.3 Fund balance placements or status
 - 6.2.4 Status of loan receivables
 - 6.2.5 Total loan portfolio
 - 6.3 After due accounting and audit, remaining balances of credit programs implemented by GNFA's and GOCCs will be transferred to GFIs in the form of special time deposits and/or trust funds. The funds will be deposited in the name of the concerned GNFA/GOCC and will bear special time deposit rates. Interest earnings will form part of the General Fund.
 - 6.4 Outstanding loans of phased-out DCPs, shall likewise, be transferred to GFIs but will be treated as off-balance sheet accounts. Collections on outstanding loans shall form part of the GNFA/GOCC account with the GFI.
 - 6.5 Collection of all outstanding loans of phased-out DCPs shall be covered by a collection and servicing agreement between GNFA/GOCC and GFI thereby the main responsibility of the GFI to which the credit funds have been transferred. An administrative fee representing a certain percentage of the actual collection of these accounts may be paid to the GFI.
 - 6.6 The Department of Finance and the National Credit Council, in coordination with concerned government agencies and in consultation with the stakeholders, will identify interventions/programs/projects by June 2001, that will address the capability building and social preparation needs of private financial institutions engaged in the delivery of financial services.
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6.7 The phase-out and transfer process will be implemented in three stages;

6.7.1 Stage I – this will cover DCPs funded out of the national budget. The NCC in coordination with DBM and COA will work out the smooth transfer of funds from concerned GNFA to GFIs.

6.7.1.1 GNFA and GOCCs shall transfer their DCPs to GFIs of their choice within the same period stipulated in the AFMA (i.e. by February 2002).

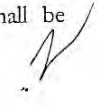
6.7.1.2 GOCCs authorized to undertake lending operations shall be allowed to continue the implementation of credit programs funded out of their own corporate funds, provided, however, that the terms and conditions of the credit programs shall be consistent with the credit policy guidelines mandated under EO 138.

6.7.1.3 Except for those credit programs mandated by law, there will be no new or additional budgetary allocation for credit programs of line agencies/GOCCs effective year 2001.

6.7.1.4 Under special agreements to be arranged by and between the concerned GNFA/GOCCs and the GFI, the GFI will implement the credit program and make the credit decisions. Setting of general policy direction (e.g. general target clientele and purpose of the lending facility) should be done by the GNFA or GOCC concerned in coordination with the GFI. Interest rates will be market-oriented as provided for in EO 138.

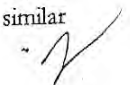
6.7.2 Stage II - this will cover DCPs that are foreign funded. The NCC in coordination with the DFA, DOF-International Finance Group (IFG), DOF-Corporate Affairs Group (CAG), NEDA and the concerned GNFA/GOCC, will renegotiate with the concerned donors to make the loan agreements and/or memorandum of agreements covering the DCPs consistent with the provisions of EO 138 and AFMA and their respective operating guidelines.

6.7.2.1 On-going foreign-assisted credit programs that are terminating on or before end-February 2002 shall continue to be implemented by GNFA and GOCCs until project completion, after which these shall be transferred to GFIs.



- 6.7.2.2 On-going foreign-assisted credit programs implemented by GNFA's and/or GOCCs that are terminating beyond end-February 2002 shall immediately be renegotiated with the creditors/donors with the objective of transferring the credit program to GFIs on or before end-February 2002.
- 6.7.2.3 There will be no new approvals for future foreign funding of credit programs directly implemented by GNFA's and GOCCs.
- 6.7.3 Stage III - This will cover DCPs that are covered by special laws. The NCC will take the initiative in proposing congressional action on these programs. The NCC may call on the concerned government agency/department for assistance, e.g. information on the credit program, advocacy with Congress, etc.

7. Implementation of directed credit programs by GFIs

- 7.1 GFIs will be the main vehicle for the delivery of wholesale funds to private financial institutions engaged in retail lending. Qualified private financial institutions may, however, be allowed as wholesalers provided appropriate safeguards are put in place. PFIs which choose and qualify as wholesalers shall not be allowed to engage in retail lending to avoid unfair competition with other PFIs. The provisions embodied in BSP No. Circular 110 Series of 1996 will be used in accreditation of PFIs as wholesalers (see attached CB Circular).
- 7.2 Directed credit programs to be implemented by GFIs including those programs that will be phased-out, shall be on-lent wholesale to participating financial institutions (including but not limited to rural banks, cooperative banks, credit cooperatives, non-governmental organizations and people's organizations). Retail lending of GFIs shall only be allowed in areas where there is no operating accredited financial conduit. In such areas, the GFI should exert all efforts in developing and strengthening its linkages with potential private sector financial conduits.
- 7.2.1 For credit programs to be transferred to the GFIs, the GNFA/GOCC concerned and the GFI will execute a memorandum of agreement indicating the purpose and broad target clientele for which the money deposited by the agency will be used. Whenever possible, the transferred credit programs shall be folded in existing credit programs of the GFI with similar purposes and target clientele.
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7.2.2 For the balance of the funds and new funds of DCPs to be transferred, GFIs shall develop appropriate accreditation and screening criteria for participating financial institutions.

7.2.3 GFIs will coordinate with the GNFA's in designing credit programs for specific clientele. GNFA's will provide the necessary support and infrastructure services (e.g. rural roads, irrigation services, post-harvest facilities, capability-building and social preparation assistance) to the targeted clientele to strengthen their viability and ensure their bankability.

7.2.4 Loans of GFIs to participating FIs shall be lent at rates not lower than market-based interest rates which is defined as the prevailing 91-day Treasury Bill weighted average interest rate (WAIR) at the time of disbursement of the loan and availment by the PFI.

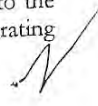
7.3 Credit programs that are foreign-funded

7.3.1 GFIs' borrowings from foreign sources for on-lending purposes may be allowed if the terms and conditions of the funding shall conform to the credit policy of EO 138 and its operating guidelines.

7.3.2 The NEDA Investment Coordination Committee (NEDA-ICC) shall require prior endorsement of the National Credit Council before any proposed credit program or projects with credit components funded by foreign loans and/or grants shall be deliberated upon and approved by the Committee prior to negotiations. Any deviation from the preliminary terms and conditions set by the ICC and the NCC and agreed upon during negotiations shall require NCC prior clearance for ICC notation before any final approval can be granted by the ICC and the BSP Monetary Board, as the case may be.

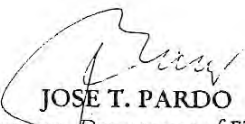
7.3.3 Grants from donor agencies shall be used by GNFA's/GOCCs to finance capability-building and support services that will improve the viability and bankability of the GFI-implemented credit programs' targetted clientele.

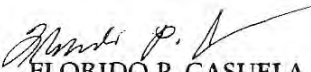
7.3.4 Grant funds for on-lending may be allowed for as long as the relending terms and conditions of the funds shall conform to the basic credit policy principles of EO 138 and its operating guidelines.



- 7.4. In the case of the Agriculture Modernization Credit and Financing Program (AMCFP), the Agricultural Credit Policy Council (ACPC) shall have oversight function over the AMCFP. The ACPC Secretariat shall monitor and evaluate the program.
8. In coordination with the NCC, DBM and COA and the concerned wholesalers, each of the GNFA's currently implementing DCP's will formulate a DCP phase-out plan following these guidelines.

Approved by the National Credit Council Executive Committee on 29th day of March 2000.


JOSE T. PARDO
*Secretary, Department of Finance and
Chairman, National Credit Council*


FLORIDO P. CASUELA
*President, Land Bank of the Philippines and
Co-Chairman, National Credit Council*

REPUBLIC ACT NO. 8791

AN ACT PROVIDING FOR THE REGULATION OF THE ORGANIZATION AND OPERATIONS OF BANKS, QUASI-BANKS, TRUST ENTITIES AND FOR OTHER PURPOSES

CHAPTER I TITLE AND CLASSIFICATION OF BANKS

SECTION 1. Title. — The short title of this Act shall be "The General Banking Law of 2000." (1a)

SECTION 2. Declaration of Policy. — The State recognizes the vital role of banks in providing an environment conducive to the sustained development of the national economy and the fiduciary nature of banking that requires high standards of integrity and performance. In furtherance thereof, the State shall promote and maintain a stable and efficient banking and financial system that is globally competitive, dynamic and responsive to the demands of a developing economy. (n)

SECTION 3. Definition and Classification of Banks. —

3.1. "Banks" shall refer to entities engaged in the lending of funds obtained in the form of deposits.
(2a)

3.2. Banks shall be classified into:

- (a) Universal banks;
- (b) Commercial banks;
- (c) Thrift banks, composed of: (i) Savings and mortgage banks, (ii) Stock savings and loan associations, and (iii) Private development banks, as defined in Republic Act No. 7906 (hereafter the "Thrift Banks Act");
- (d) Rural banks, as defined in Republic Act No. 7353 (hereafter the "Rural Banks Act");
- (e) Cooperative banks, as defined in Republic Act No. 6938 (hereafter the "Cooperative Code");
- (f) Islamic banks as defined in Republic Act No. 6848, otherwise known as the "Charter of Al Amanah Islamic Investment Bank of the Philippines"; and
- (g) Other classifications of banks as determined by the Monetary Board of the Bangko Sentral ng Pilipinas. (6-Aa)

CHAPTER II AUTHORITY OF THE BANGKO SENTRAL

SECTION 4. Supervisory Powers. — The operations and activities of banks shall be subject to supervision of the Bangko Sentral. "Supervision" shall include the following:

- 4.1. The issuance of rules of conduct or the establishment of standards of operation for uniform application to all institutions or functions covered, taking into consideration the distinctive character of the operations of institutions and the substantive similarities of specific functions to which such rules, modes or standards are to be applied;

- 4.2. The conduct of examination to determine compliance with laws and regulations if the circumstances so warrant as determined by the Monetary Board;
- 4.3. Overseeing to ascertain that laws and regulations are complied with;
- 4.4. Regular investigation which shall not be oftener than once a year from the last date of examination to determine whether an institution is conducting its business on a safe or sound basis: Provided, That the deficiencies/irregularities found by or discovered by an audit shall be immediately addressed;
- 4.5. Inquiring into the solvency and liquidity of the institution (2-D); or
- 4.6. Enforcing prompt corrective action. (n)

The Bangko Sentral shall also have supervision over the operations of and exercise regulatory powers over quasi-banks, trust entities and other financial institutions which under special laws are subject to Bangko Sentral supervision. (2-Ca)

For the purposes of this Act, "quasi-banks" shall refer to entities engaged in the borrowing of funds through the issuance, endorsement or assignment with recourse or acceptance of deposit substitutes as defined in Section 95 of Republic Act No. 7653 (hereafter the "New Central Bank Act") for purposes of relending or purchasing of receivables and other obligations. (2-Da)

SECTION 5. Policy Direction: Ratios, Ceilings and Limitations. — The Bangko Sentral shall provide policy direction in the areas of money, banking and credit. (n)

For this purpose, the Monetary Board may prescribe ratios, ceilings, limitations, or other forms of regulation on the different types of accounts and practices of banks and quasi-banks which shall, to the extent feasible, conform to internationally accepted standards, including those of the Bank for International Settlements (BIS). The Monetary Board may exempt particular categories of transactions from such ratios, ceilings and limitations, but not limited to exceptional cases or to enable a bank or quasi-bank under rehabilitation or during a merger or consolidation to continue in business with safety to its creditors, depositors and the general public. (2-Ca)

SECTION 6. Authority to Engage in Banking and Quasi-Banking Functions. — No person or entity shall engage in banking operations or quasi-banking functions without authority from the Bangko Sentral: Provided, however, That an entity authorized by the Bangko Sentral to perform universal or commercial banking functions shall likewise have the authority to engage in quasi-banking functions.

The determination of whether a person or entity is performing banking or quasi-banking functions without Bangko Sentral authority shall be decided by the Monetary Board. To resolve such issue, the Monetary Board may, through the appropriate supervising and examining department of the Bangko Sentral, examine, inspect or investigate the books and records of such person or entity. Upon issuance of this authority, such person or entity may commence to engage in banking operations or quasi-banking functions and shall continue to do so unless such authority is sooner surrendered, revoked, suspended or annulled by the Bangko Sentral in accordance with this Act or other special laws.

The department head and the examiners of the appropriate supervising and examining department are hereby authorized to administer oaths to any such person, employee, officer, or director of any such entity and to compel the presentation or production of such books, documents, papers or records that are reasonably necessary to ascertain the facts relative to the true functions and operations of such person or entity. Failure or refusal to comply with the required presentation or production of such books, documents, papers or records within a reasonable time shall subject the persons responsible therefore to the penal sanctions provided under the New Central Bank Act.

Persons or entities found to be performing banking or quasi-banking functions without authority from the Bangko Sentral shall be subject to appropriate sanctions under the New Central Bank Act and other applicable laws. (4a)

SECTION 7. Examination by the Bangko Sentral. — The Bangko Sentral shall, when examining a bank, have the authority to examine an enterprise which is wholly or majority-owned or controlled by the bank. (21-Ba)

CHAPTER III

ORGANIZATION, MANAGEMENT AND ADMINISTRATION OF BANKS, QUASI-BANKS AND TRUST ENTITIES

SECTION 8. Organization. — The Monetary Board may authorize the organization of a bank or quasi-bank subject to the following conditions:

- 8.1. That the entity is a stock corporation (7);
- 8.2. That its funds are obtained from the public, which shall mean twenty (20) or more persons (2-Da); and
- 8.3. That the minimum capital requirements prescribed by the Monetary Board for each category of banks are satisfied. (n)

No new commercial bank shall be established within three (3) years from the effectivity of this Act. In the exercise of the authority granted herein, the Monetary Board shall take into consideration their capability in terms of their financial resources and technical expertise and integrity. The bank licensing process shall incorporate an assessment of the bank's ownership structure, directors and senior management, its operating plan and internal controls as well as its projected financial condition and capital base.

SECTION 9. Issuance of Stocks. — The Monetary Board may prescribe rules and regulations on the types of stock a bank may issue, including the terms thereof and rights appurtenant thereto to determine compliance with laws and regulations governing capital and equity structure of banks: Provided, That banks shall issue par value stocks only.

SECTION 10. Treasury Stocks. — No bank shall purchase or acquire shares of its own capital stock or accept its own shares as a security for a loan, except when authorized by the Monetary Board: Provided, That in every case the stock so purchased or acquired shall, within six (6) months from the time of its purchase or acquisition, be sold or disposed of at a public or private sale. (24a)

SECTION 11. Foreign Stockholdings. — Foreign individuals and non-bank corporations may own or control up to forty percent (40%) of the voting stock of a domestic bank. This rule shall apply to Filipinos and domestic non-bank corporations. (12a; 12-Aa)

The percentage of foreign-owned voting stocks in a bank shall be determined by the citizenship of the individual stockholders in that bank. The citizenship of the corporation which is a stockholder in a bank shall follow the citizenship of the controlling stockholders of the corporation, irrespective of the place of incorporation. (n)

SECTION 12. Stockholdings of Family Groups or Related Interests. — Stockholdings of individuals related to each other within the fourth degree of consanguinity or affinity, legitimate or

common-law, shall be considered family groups or related interests and must be fully disclosed in all transactions by such an individual with the bank. (12-Da)

SECTION 13. Corporate Stockholdings. — Two or more corporations owned or controlled by the same family group or same group of persons shall be considered related interests and must be fully disclosed in all transactions by such corporations or related groups of persons with the bank. (12-Ba)

SECTION 14. Certificate of Authority to Register. — The Securities and Exchange Commission shall not register the articles of incorporation of any bank, or any amendment thereto, unless accompanied by a certificate of authority issued by the Monetary Board, under its seal. Such certificate shall not be issued unless the Monetary Board is satisfied from the evidence submitted to it:

- 14.1 That all requirements of existing laws and regulations to engage in the business for which the applicant is proposed to be incorporated have been complied with;
- 14.2. That the public interest and economic conditions, both general and local, justify the authorization; and
- 14.3. That the amount of capital, the financing, organization, direction and administration, as well as the integrity and responsibility of the organizers and administrators reasonably assure the safety of deposits and the public interest. (9)

The Securities and Exchange Commission shall not register the by-laws of any bank, or any amendment thereto, unless accompanied by a certificate of authority from the Bangko Sentral. (10)

SECTION 15. Board of Directors. — The provisions of the Corporation Code to the contrary notwithstanding, there shall be at least five (5), and a maximum of fifteen (15) members of the board of directors of bank, two (2) of whom shall be independent directors. An "independent director" shall mean a person other than an officer or employee of the bank, its subsidiaries or affiliates or related interests. (n)

Non-Filipino citizens may become members of the board of directors of a bank to the extent of the foreign participation in the equity of said bank. (Sec. 7, RA 7721)

The meetings of the board of directors may be conducted through modern technologies such as, but not limited to, teleconferencing and video-conferencing. (n)

SECTION 16. Fit and Proper Rule. — To maintain the quality of bank management and afford better protection to depositors and the public in general, the Monetary Board shall prescribe, pass upon and review the qualifications and disqualifications of individuals elected or appointed bank directors or officers and disqualify those found unfit.

After due notice to the board of directors of the bank, the Monetary Board may disqualify, suspend or remove any bank director or officer who commits or omits an act which render him unfit for the position.

In determining whether an individual is fit and proper to hold the position of a director or officer of a bank, regard shall be given to his integrity, experience, education, training, and competence. (9-Aa)

SECTION 17. Directors of Merged or Consolidated Banks. — In the case of a bank merger or consolidation, the number of directors shall not exceed twenty-one (21). (13a)

SECTION 18. Compensation and Other Benefits of Directors and Officers. — To protect the funds of depositors and creditors, the Monetary Board may regulate the payment by the bank to its directors and officers of compensation, allowance, fees, bonuses, stock options, profit sharing and fringe benefits only in exceptional cases and when the circumstances warrant, such as but not limited to the following:

- 18.1. When a bank is under comptrollership or conservatorship; or
- 18.2. When a bank is found by the Monetary Board to be conducting business in an unsafe or unsound manner; or
- 18.3. When a bank is found by the Monetary Board to be in an unsatisfactory financial condition.
(n)

SECTION 19. Prohibition on Public Officials. — Except as otherwise provided in the Rural Banks Act, no appointive or elective public official, whether full-time or part-time shall at the same time serve as officer of any private bank, save in cases where such service is incident to financial assistance provided by the government or a government-owned or controlled corporation to the bank or unless otherwise provided under existing laws. (13)

SECTION 20. Bank Branches. — Universal or commercial banks may open branches or other offices within or outside the Philippines upon prior approval of the Bangko Sentral.

Branching by all other banks shall be governed by pertinent laws.

A bank may, subject to prior approval of the Monetary Board, use any or all of its branches as outlets for the presentation and/or sale of the financial products of its allied undertaking or of its investment house units.

A bank authorized to establish branches or other offices shall be responsible for all business conducted in such branches and offices to the same extent and in the same manner as though such business had all been conducted in the head office. A bank and its branches and offices shall be treated as one unit. (6-B; 27)

SECTION 21. Banking Days and Hours. — Unless otherwise authorized by the Bangko Sentral in the interest of the banking public, all banks including their branches and offices shall transact business on all working days for at least six (6) hours a day. In addition, banks or any of their branches or offices may open for business on Saturdays, Sundays or holidays for at least three (3) hours a day: Provided, That banks which opt to open on days other than working days shall report to the Bangko Sentral the additional days during which they or their branches or offices shall transact business.

For purposes of this Section, working days shall mean Mondays to Fridays, except if such days are holidays. (6-Ca)

SECTION 22. Strikes and Lockouts. — The banking industry is hereby declared as indispensable to the national interest and, notwithstanding the provisions of any law to the contrary, any strike or lockout involving banks, if unsettled after seven (7) calendar days shall be reported by the Bangko Sentral to the Secretary of Labor who may assume jurisdiction over the dispute or decide it or certify the same to the National Labor Relations Commission for compulsory arbitration. However, the President of the Philippines may at any time intervene and assume jurisdiction over such labor dispute in order to settle or terminate the same. (6-E)

CHAPTER IV DEPOSITS, LOANS AND OTHER OPERATIONS

ARTICLE I - OPERATIONS OF UNIVERSAL BANKS

SECTION 23. Powers of a Universal Bank. — A universal bank shall have the authority to exercise, in addition to the powers authorized for a commercial bank in Section 29, the powers of an investment house as provided in existing laws and the power to invest in non-allied enterprises as provided in this Act. (21-B)

SECTION 24. Equity Investments of a Universal Bank. — A universal bank may, subject to the conditions stated in the succeeding paragraph, invest in the equities of allied and non-allied enterprises as may be determined by the Monetary Board. Allied enterprises may either be financial or non-financial.

Except as the Monetary Board may otherwise prescribe:

- 24.1. The total investment in equities of allied and non-allied enterprises shall not exceed fifty percent (50%) of the net worth of the bank; and
- 24.2. The equity investment in any one enterprise, whether allied or non-allied, shall not exceed twenty-five percent (25%) of the net worth of the bank.

As used in this Act, "net worth" shall mean the total of the unimpaired paid-in capital including paid-in surplus, retained earnings and undivided profit, net of valuation reserves and other adjustments as may be required by the Bangko Sentral.

The acquisition of such equity or equities is subject to the prior approval of the Monetary Board which shall promulgate appropriate guidelines to govern such investments. (21-Ba)

SECTION 25. Equity Investments of a Universal Bank in Financial Allied Enterprises. — A universal bank can own up to one hundred percent (100%) of the equity in a thrift bank, a rural bank or a financial allied enterprise.

A publicly-listed universal or commercial bank may own up to one hundred percent (100%) of the voting stock of only one other universal or commercial bank. (21-B; 21-Ca)

SECTION 26. Equity Investments of a Universal Bank in Non-Financial Allied Enterprises. — A universal bank may own up to one hundred percent (100%) of the equity in a non-financial allied enterprise. (21-Ba)

SECTION 27. Equity Investments of a Universal Bank in Non-Allied Enterprises. — The equity investment of a universal bank, or of its wholly or majority-owned subsidiaries, in a single non-allied enterprise shall not exceed thirty-five percent (35%) of the total equity in that enterprise nor shall it exceed thirty-five percent (35%) of the voting stock in that enterprise. (21-B)

SECTION 28. Equity Investments in Quasi-Banks. — To promote competitive conditions in financial markets, the Monetary Board may further limit to forty percent (40%) equity investments of universal banks in quasi-banks. This rule shall also apply in the case of commercial banks. (12-E)

ARTICLE II - OPERATIONS OF COMMERCIAL BANKS

SECTION 29. Powers of a Commercial Bank. — A commercial bank shall have, in addition to the general powers incident to corporations, all such powers as may be necessary to carry on the business of commercial banking, such as accepting drafts and issuing letters of credit; discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; accepting or creating demand deposits; receiving other types of deposits and deposit substitutes; buying and selling foreign exchange and gold or silver bullion; acquiring marketable bonds and other debt securities; and extending credit, subject to such rules as the Monetary Board may promulgate. These rules may include the

determination of bonds and other debt securities eligible for investment, the maturities and aggregate amount of such investment. (21a)

SECTION 30. Equity Investments of a Commercial Bank. — A commercial bank may, subject to the conditions stated in the succeeding paragraphs, invest only in the equities of allied enterprises as may be determined by the Monetary Board. Allied enterprises may either be financial or non-financial.

Except as the Monetary Board may otherwise prescribe:

- 30.1. The total investment in equities of allied enterprises shall not exceed thirty-five percent (35%) of the net worth of the bank; and
- 30.2. The equity investment in any one enterprise shall not exceed twenty-five percent (25%) of the net worth of the bank.

The acquisition of such equity or equities is subject to the prior approval of the Monetary Board which shall promulgate appropriate guidelines to govern such investments. (21A-a; 21-Ca)

SECTION 31. Equity Investments of a Commercial Bank in Financial Allied Enterprises. — A commercial bank may own up to one hundred percent (100%) of the equity of a thrift bank or a rural bank.

Where the equity investment of a commercial bank is in other financial allied enterprises, including another commercial bank, such investment shall remain a minority holding in that enterprise. (21-Aa; 21-Ca)

SECTION 32. Equity Investments of a Commercial Bank in Non-Financial Allied Enterprises. — A commercial bank may own up to one hundred percent (100%) of the equity in a non-financial allied enterprise. (21-Aa)

ARTICLE III - PROVISIONS APPLICABLE TO ALL BANKS, QUASI-BANKS, AND TRUST ENTITIES

SECTION 33. Acceptance of Demand Deposits. — A bank other than a universal or commercial bank cannot accept or create demand deposits except upon prior approval of, and subject to such conditions and rules as may be prescribed by the Monetary Board. (72-Aa)

SECTION 34. Risk-Based Capital. — The Monetary Board shall prescribe the minimum ratio which the net worth of a bank must bear to its total risk assets which may include contingent accounts.

For purposes of this Section, the Monetary Board may require that such ratio be determined on the basis of the net worth and risk assets of a bank and its subsidiaries, financial or otherwise, as well as prescribe the composition and the manner of determining the net worth and total risk assets of banks and their subsidiaries: Provided, That in the exercise of this authority, the Monetary Board shall, to the extent feasible, conform to internationally accepted standards, including those of the Bank for International Settlements (BIS), relating to risk-based capital requirements: Provided, further, That it may alter or suspend compliance with such ratio whenever necessary for a maximum period of one (1) year: Provided, finally, That such ratio shall be applied uniformly to banks of the same category.

In case a bank does not comply with the prescribed minimum ratio, the Monetary Board may limit or prohibit the distribution of net profits by such bank and may require that part or all of the net profits be used to increase the capital accounts of the bank until the minimum requirement has been met. The Monetary Board may, furthermore, restrict or prohibit the acquisition of major assets and the making of

new investments by the bank, with the exception of purchases of readily marketable evidences of indebtedness of the Republic of the Philippines and of the Bangko Sentral and any other evidences of indebtedness or obligations the servicing and repayment of which are fully guaranteed by the Republic of the Philippines, until the minimum required capital ratio has been restored.

In case of a bank merger or consolidation, or when a bank is under rehabilitation under a program approved by the Bangko Sentral, the Monetary Board may temporarily relieve the surviving bank, consolidated bank, or constituent bank or corporations under rehabilitation from full compliance with the required capital ratio under such conditions as it may prescribe.

Before the effectivity of the rules which the Monetary Board is authorized to prescribe under this provision, Section 22 of the General Banking Act, as amended, Section 9 of the Thrift Banks Act, and all pertinent rules issued pursuant thereto, shall continue to be in force. (22a)

SECTION 35. Limit on Loans, Credit Accommodations and Guarantees. —

- 35.1. Except as the Monetary Board may otherwise prescribe for reasons of national interest, the total amount of loans, credit accommodations and guarantees as may be defined by the Monetary Board that may be extended by a bank to any person, partnership, association, corporation or other entity shall at no time exceed twenty percent (20%) of the net worth of such bank. The basis for determining compliance with single-borrower limit is the total credit commitment of the bank to the borrower.
- 35.2. Unless the Monetary Board prescribes otherwise, the total amount of loans, credit accommodations and guarantees prescribed in the preceding paragraph may be increased by an additional ten percent (10%) of the net worth of such bank provided the additional liabilities of any borrower are adequately secured by trust receipts, shipping documents, warehouse receipts or other similar documents transferring or securing title covering readily marketable, non-perishable goods which must be fully covered by insurance.
- 35.3. The above prescribed ceilings shall include: (a) the direct liability of the maker or acceptor of paper discounted with or sold to such bank and the liability of a general indorser, drawer or guarantor who obtains a loan or other credit accommodation from or discounts paper with or sells papers to such bank; (b) in the case of an individual who owns or controls a majority interest in a corporation, partnership, association or any other entity, the liabilities of said entities to such bank; (c) in the case of a corporation, all liabilities to such bank of all subsidiaries in which such corporation owns or controls a majority interest; and (d) in the case of a partnership, association or other entity, the liabilities of the members thereof to such bank.
- 35.4. Even if a parent corporation, partnership, association, entity or an individual who owns or controls a majority interest in such entities has no liability to the bank, the Monetary Board may prescribe the combination of the liabilities of subsidiary corporations or members of the partnership, association, entity or such individual under certain circumstances, including but not limited to any of the following situations: (a) the parent corporation, partnership, association, entity or individual guarantees the repayment of the liabilities; (b) the liabilities were incurred for the accommodation of the parent corporation or another subsidiary or of the partnership or association or entity or such individual; or (c) the subsidiaries though separate entities operate merely as departments or divisions of a single entity.
- 35.5. For purposes of this Section, loans, other credit accommodations and guarantees shall exclude:

(a) loans and other credit accommodations secured by obligations of the Bangko Sentral or of the Philippine Government; (b) loans and other credit accommodations fully guaranteed by the government as to the payment of principal and interest; (c) loans and other credit accommodations

covered by assignment of deposits maintained in the lending bank and held in the Philippines; (d) loans, credit accommodations and acceptances under letters of credit to the extent covered by margin deposits; and (e) other loans or credit accommodations which the Monetary Board may from time to time, specify as non-risk items.

35.6. Loans and other credit accommodations, deposits maintained with, and usual guarantees by a bank to any other bank or non-bank entity, whether locally or abroad, shall be subject to the limits as herein prescribed.

35.7. Certain types of contingent accounts of borrowers may be included among those subject to these prescribed limits as may be determined by the Monetary Board. (23a)

SECTION 36. Restriction on Bank Exposure to Directors, Officers, Stockholders and Their Related Interests. — No director or officer of any bank shall, directly or indirectly, for himself or as the representative or agent of others, borrow from such bank nor shall he become a guarantor, indorser or surety for loans from such bank to others, or in any manner be an obligor or incur any contractual liability to the bank except with the written approval of the majority of all the directors of the bank, excluding the director concerned: Provided, That such written approval shall not be required for loans, other credit accommodations and advances granted to officers under a fringe benefit plan approved by the Bangko Sentral. The required approval shall be entered upon the records of the bank and a copy of such entry shall be transmitted forthwith to the appropriate supervising and examining department of the Bangko Sentral.

Dealings of a bank with any of its directors, officers or stockholders and their related interests shall be upon terms not less favorable to the bank than those offered to others.

After due notice to the board of directors of the bank, the office of any bank director or officer who violates the provisions of this Section may be declared vacant and the director or officer shall be subject to the penal provisions of the New Central Bank Act.

The Monetary Board may regulate the amount of loans, credit accommodations and guarantees that may be extended, directly or indirectly, by a bank to its directors, officers, stockholders and their related interests, as well as investments of such bank in enterprises owned or controlled by said directors, officers, stockholders and their related interests. However, the outstanding loans, credit accommodations and guarantees which a bank may extend to each of its stockholders, directors, or officers and their related interests, shall be limited to an amount equivalent to their respective unencumbered deposits and book value of their paid-in capital contribution in the bank: Provided, however, That loans, credit accommodations and guarantees secured by assets considered as non-risk by the Monetary Board shall be excluded from such limit: Provided, further, That loans, credit accommodations and advances to officers in the form of fringe benefits granted in accordance with rules as may be prescribed by the Monetary Board shall not be subject to the individual limit.

The Monetary Board shall define the term "related interests."

The limit on loans, credit accommodations and guarantees prescribed herein shall not apply to loans, credit accommodations and guarantees extended by a cooperative bank to its cooperative shareholders. (83a)

SECTION 37. Loans and Other Credit Accommodations Against Real Estate. — Except as the Monetary Board may otherwise prescribe, loans and other credit accommodations against real estate shall not exceed seventy-five percent (75%) of the appraised value of the respective real estate security, plus sixty percent (60%) of the appraised value of the insured improvements, and such loans may be made to the owner of the real estate or to his assignees. (78a)

SECTION 38. Loans and Other Credit Accommodations on Security of Chattels and Intangible Properties. — Except as the Monetary Board may otherwise prescribe, loans and other credit

accommodations on security of chattels and intangible properties, such as, but not limited to, patents, trademarks, trade names, and copyrights shall not exceed seventy-five percent (75%) of the appraised value of the security, and such loans and other credit accommodations may be made to the title-holder of the chattels and intangible properties or his assignees. (78a)

SECTION 39. Grant and Purpose of Loans and Other Credit Accommodations. — A bank shall grant loans and other credit accommodations only in amounts and for the periods of time essential for the effective completion of the operations to be financed. Such grant of loans and other credit accommodations shall be consistent with safe and sound banking practices. (75a)

The purpose of all loans and other credit accommodations shall be stated in the application and in the contract between the bank and the borrower. If the bank finds that the proceeds of the loan or other credit accommodation have been employed, without its approval, for purposes other than those agreed upon with the bank, it shall have the right to terminate the loan or other credit accommodation and demand immediate repayment of the obligation. (77)

SECTION 40. Requirement for Grant of Loans or Other Credit Accommodations. — Before granting a loan or other credit accommodation, a bank must ascertain that the debtor is capable of fulfilling his commitments to the bank.

Toward this end, a bank may demand from its credit applicants a statement of their assets and liabilities and of their income and expenditures and such information as may be prescribed by law or by rules and regulations of Monetary Board to enable the bank to properly evaluate the credit application which includes the corresponding financial statements submitted for taxation purposes to the Bureau of Internal Revenue. Should such statements prove to be false or incorrect in any material detail, the bank may terminate any loan or other credit accommodation granted on the basis of said statements and shall have the right to demand immediate repayment or liquidation of the obligation.

In formulating rules and regulations under this Section, the Monetary Board shall recognize the peculiar characteristics of microfinancing, such as cash flow-based lending to the basic sectors that are not covered by traditional collateral. (76a)

SECTION 41. Unsecured Loans or Other Credit Accommodations. — The Monetary Board is hereby authorized to issue such regulations as it may deem necessary with respect to unsecured loans or other credit accommodations that may be granted by banks. (n)

SECTION 42. Other Security Requirements for Bank Credits. — The Monetary Board may, by regulation, prescribe further security requirements to which the various types of bank credits shall be subject, and, in accordance with the authority granted to it in Section 106 of the New Central Bank Act, the Board may by regulation, reduce the maximum ratios established in Sections 36 and 37 of this Act, or, in special cases, increase the maximum ratios established therein. (78)

SECTION 43. Authority to Prescribe Terms and Conditions of Loans and Other Credit Accommodations. — The Monetary Board may, similarly, in accordance with the authority granted to it in Section 106 of the New Central Bank Act, and taking into account the requirements of the economy for the effective utilization of long-term funds, prescribe the maturities, as well as related terms and conditions for various types of bank loans and other credit accommodations. Any change by the Board in the maximum maturities shall apply only to loans and other credit accommodations made after the date of such action.

The Monetary Board shall regulate the interest imposed on microfinance borrowers by lending investors and similar lenders, such as, but not limited to, the unconscionable rates of interest collected on salary loans and similar credit accommodations. (78a)

SECTION 44. Amortization on Loans and Other Credit Accommodations. — The amortization schedule of bank loans and other credit accommodations shall be adapted to the nature of the operations to be financed.

In case of loans and other credit accommodations with maturities of more than five (5) years, provisions must be made for periodic amortization payments, but such payments must be made at least annually: Provided, however, That when the borrowed funds are to be used for purposes which do not initially produce revenues adequate for regular amortization payments therefrom, the bank may permit the initial amortization payment to be deferred until such time as said revenues are sufficient for such purpose, but in no case shall the initial amortization date be later than five (5) years from the date on which the loan or other credit accommodation is granted. (79a)

In case of loans and other credit accommodations to microfinance sectors, the schedule of loan amortization shall take into consideration the projected cash flow of the borrower and adopt this into the terms and conditions formulated by banks. (n)

SECTION 45. Prepayment of Loans and Other Credit Accommodations. — A borrower may at any time prior to the agreed maturity date prepay, in whole or in part, the unpaid balance of any bank loan and other credit accommodation, subject to such reasonable terms and conditions as may be agreed upon between the bank and its borrower. (80a)

SECTION 46. Development Assistance Incentives. — The Bangko Sentral shall provide incentives to banks which, without government guarantee, extend loans to finance educational institutions, cooperatives, hospitals and other medical services, socialized or low-cost housing, local government units and other activities with social content. (n)

SECTION 47. Foreclosure of Real Estate Mortgage. — In the event of foreclosure, whether judicially or extrajudicially, of any mortgage on real estate which is security for any loan or other credit accommodation granted, the mortgagor or debtor whose real property has been sold for the full or partial payment of his obligation shall have the right within one year after the sale of the real estate, to redeem the property by paying the amount due under the mortgage deed, with interest thereon at the rate specified in the mortgage, and all the costs and expenses incurred by the bank or institution from the sale and custody of said property less the income derived therefrom. However, the purchaser at the auction sale concerned whether in a judicial or extrajudicial foreclosure shall have the right to enter upon and take possession of such property immediately after the date of the confirmation of the auction sale and administer the same in accordance with law. Any petition in court to enjoin or restrain the conduct of foreclosure proceedings instituted pursuant to this provision shall be given due course only upon the filing by the petitioner of a bond in an amount fixed by the court conditioned that he will pay all the damages which the bank may suffer by the enjoining or the restraint of the foreclosure proceeding.

Notwithstanding Act 3135, juridical persons whose property is being sold pursuant to an extrajudicial foreclosure, shall have the right to redeem the property in accordance with this provision until, but not after, the registration of the certificate of foreclosure sale with the applicable Register of Deeds which in no case shall be more than three (3) months after foreclosure, whichever is earlier. Owners of property that has been sold in a foreclosure sale prior to the effectivity of this Act shall retain their redemption rights until their expiration. (78a)

SECTION 48. Renewal or Extension of Loans and Other Credit Accommodations. — The Monetary Board may, by regulation, prescribe the conditions and limitations under which a bank may grant extensions or renewals of its loans and other credit accommodations. (81)

SECTION 49. Provisions for Losses and Write-Offs. — All debts due to any bank on which interest is past due and unpaid for such period as may be determined by the Monetary Board, unless the same are well-secured and in the process of collection shall be considered bad debts within the meaning of this Section.

The Monetary Board may fix, by regulation or by order in a specific case, the amount of reserves for bad debts or doubtful accounts or other contingencies.

Writing off of loans, other credit accommodations, advances and other assets shall be subject to regulations issued by the Monetary Board. (84a)

SECTION 50. Major Investments. — For the purpose of enhancing bank supervision, the Monetary Board shall establish criteria for reviewing major acquisitions or investments by a bank including corporate affiliations or structures that may expose the bank to undue risks or in any way hinder effective supervision.

SECTION 51. Ceiling on Investments in Certain Assets. — Any bank may acquire real estate as shall be necessary for its own use in the conduct of its business: Provided, however, That the total investment in such real estate and improvements thereof, including bank equipment, shall not exceed fifty percent (50%) of combined capital accounts: Provided, further, That the equity investment of a bank in another corporation engaged primarily in real estate shall be considered as part of the bank's total investment in real estate, unless otherwise provided by the Monetary Board. (25a)

SECTION 52. Acquisition of Real Estate by Way of Satisfaction of Claims. — Notwithstanding the limitations of the preceding Section, a bank may acquire, hold or convey real property under the following circumstances:

- 52.1. Such as shall be mortgaged to it in good faith by way of security for debts;
- 52.2. Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings; or
- 52.3. Such as it shall purchase at sales under judgments, decrees, mortgages, or trust deeds held by it and such as it shall purchase to secure debts due it.

Any real property acquired or held under the circumstances enumerated in the above paragraph shall be disposed of by the bank within a period of five (5) years or as may be prescribed by the Monetary Board: Provided, however, That the bank may, after said period, continue to hold the property for its own use, subject to the limitations of the preceding Section. (25a)

SECTION 53. Other Banking Services. — In addition to the operations specifically authorized in this Act, a bank may perform the following services:

- 53.1. Receive in custody funds, documents and valuable objects;
- 53.2. Act as financial agent and buy and sell, by order of and for the account of their customers, shares, evidences of indebtedness and all types of securities;
- 53.3. Make collections and payments for the account of others and perform such other services for their customers as are not incompatible with banking business;
- 53.4. Upon prior approval of the Monetary Board, act as managing agent, adviser, consultant or administrator of investment management/advisory/consultancy accounts; and
- 53.5. Rent out safety deposit boxes.

The bank shall perform the services permitted under Subsections 53.1, 53.2, 53.3 and 53.4 as depository or as an agent. Accordingly, it shall keep the funds, securities and other effects which it receives duly separate from the bank's own assets and liabilities.

The Monetary Board may regulate the operations authorized by this Section in order to ensure that such operations do not endanger the interests of the depositors and other creditors of the bank.

In case a bank or quasi-bank notifies the Bangko Sentral or publicly announces a bank holiday, or in any manner suspends the payment of its deposit liabilities continuously for more than thirty (30) days, the Monetary Board may summarily and without need for prior hearing close such banking institution and place it under receivership of the Philippine Deposit Insurance Corporation. (72a)

SECTION 54. Prohibition to Act as Insurer. — A bank shall not directly engage in insurance business as the insurer. (73)

SECTION 55. Prohibited Transactions. —

55.1. No director, officer, employee, or agent of any bank shall —

- (a) Make false entries in any bank report or statement or participate in any fraudulent transaction, thereby affecting the financial interest of, or causing damage to, the bank or any person;
- (b) Without order of a court of competent jurisdiction, disclose to any unauthorized person any information relative to the funds or properties in the custody of the bank belonging to private individuals, corporations, or any other entity: Provided, That with respect to bank deposits, the provisions of existing laws shall prevail;
- (c) Accept gifts, fees or commissions or any other form of remuneration in connection with the approval of a loan or other credit accommodation from said bank;
- (d) Overvalue or aid in overvaluing any security for the purpose of influencing in any way the actions of the bank or any bank; or
- (e) Outsource inherent banking functions.

55.2. No borrower of a bank shall —

- (a) Fraudulently overvalue property offered as security for a loan or other credit accommodation from the bank;
- (b) Furnish false or make misrepresentation or suppression of material facts for the purpose of obtaining, renewing, or increasing a loan or other credit accommodation or extending the period thereof;
- (c) Attempt to defraud the said bank in the event of a court action to recover a loan or other credit accommodation; or
- (d) Offer any director, officer, employee or agent of a bank any gift, fee, commission, or any other form of compensation in order to influence such persons into approving a loan or other credit accommodation application.

55.3. No examiner, officer or employee of the Bangko Sentral or of any department, bureau, office, branch or agency of the Government that is assigned to supervise, examine, assist or render technical assistance to any bank shall commit any of the acts enumerated in this Section or aid in the commission of the same. (87-Aa)

The making of false reports or misrepresentation or suppression of material facts by personnel of the Bangko Sentral ng Pilipinas shall constitute fraud and shall be subject to the administrative and criminal sanctions provided under the New Central Bank Act.

- 55.4. Consistent with the provisions of Republic Act No. 1405, otherwise known as the Banks Secrecy Law, no bank shall employ casual or nonregular personnel or too lengthy probationary personnel in the conduct of its business involving bank deposits.

SECTION 56. Conducting Business in an Unsafe or Unsound Manner. — In determining whether a particular act or omission, which is not otherwise prohibited by any law, rule or regulation affecting banks, quasi-banks or trust entities, may be deemed as conducting business in an unsafe or unsound manner for purposes of this Section, the Monetary Board shall consider any of the following circumstances:

- 56.1. The act or omission has resulted or may result in material loss or damage, or abnormal risk or danger to the safety, stability, liquidity or solvency of the institution;
- 56.2. The act or omission has resulted or may result in material loss or damage or abnormal risk to the institution's depositors, creditors, investors, stockholders or to the Bangko Sentral or to the public in general;
- 56.3. The act or omission has caused any undue injury, or has given any unwarranted benefits, advantage or preference to the bank or any party in the discharge by the director or officer of his duties and responsibilities through manifest partiality, evident bad faith or gross inexcusable negligence; or
- 56.4. The act or omission involves entering into any contract or transaction manifestly and grossly disadvantageous to the bank, quasi-bank or trust entity, whether or not the director or officer profited or will profit thereby.

Whenever a bank, quasi-bank or trust entity persists in conducting its business in an unsafe or unsound manner, the Monetary Board may, without prejudice to the administrative sanctions provided in Section 37 of the New Central Bank Act, take action under Section 30 of the same Act and/or immediately exclude the erring bank from clearing, the provisions of law to the contrary notwithstanding. (n)

SECTION 57. Prohibition on Dividend Declaration. — No bank or quasi-bank shall declare dividends greater than its accumulated net profits then on hand, deducting therefrom its losses and bad debts. Neither shall the bank nor quasi-bank declare dividends, if at the time of declaration:

- 57.1 Its clearing account with the Bangko Sentral is overdrawn; or
- 57.2 It is deficient in the required liquidity floor for government deposits for five (5) or more consecutive days; or
- 57.3 It does not comply with the liquidity standards/ratios prescribed by the Bangko Sentral for purposes of determining funds available for dividend declaration; or
- 57.4 It has committed a major violation as may be determined by the Bangko Sentral. (84a)

SECTION 58. Independent Auditor. — The Monetary Board may require a bank, quasi-bank or trust entity to engage the services of an independent auditor to be chosen by the bank, quasi-bank or trust entity concerned from a list of certified public accountants acceptable to the Monetary Board. The term of the engagement shall be as prescribed by the Monetary Board which may either be on a continuing basis where the auditor shall act as resident examiner, or on the basis of special engagements, but in any case, the independent auditor shall be responsible to the bank's, quasi-bank's or trust entity's board of directors. A copy of the report shall be furnished to the Monetary Board. The Monetary Board may also direct the board of directors of a bank, quasi-bank, trust entity and/or the individual members thereof, to conduct, either personally or by a committee created by the board, an

annual balance sheet audit of the bank, quasi-bank or trust entity to review the internal audit and control system of the bank, quasi-bank or trust entity and to submit a report of such audit. (6-Da)

SECTION 59. Authority to Regulate Electronic Transactions. — The Bangko Sentral shall have full authority to regulate the use of electronic devices, such as computers, and processes for recording, storing and transmitting information or data in connection with the operations of a bank, quasi-bank or trust entity, including the delivery of services and products to customers by such entity. (n)

SECTION 60. Financial Statements. — Every bank, quasi-bank or trust entity shall submit to the appropriate supervising and examining department of the Bangko Sentral financial statements in such form and frequency as may be prescribed by the Bangko Sentral. Such statements, which shall be as of a specific date designated by the Bangko Sentral, shall show the actual financial condition of the institution submitting the statement, and of its branches, offices, subsidiaries and affiliates, including the results of its operations, and shall contain such information as may be required in Bangko Sentral regulations. (n)

SECTION 61. Publication of Financial Statements. — Every bank, quasi-bank or trust entity, shall publish a statement of its financial condition, including those of its subsidiaries and affiliates, in such terms understandable to the layman and in such frequency as may be prescribed by the Bangko Sentral, in English or Filipino, at least once every quarter in a newspaper of general circulation in the city or province where the principal office, in the case of a domestic institution, or the principal branch or office in the case of a foreign bank, is located, but if no newspaper is published in the same province, then in a newspaper published in Metro Manila or in the nearest city or province.

The Bangko Sentral may by regulation prescribe the newspaper where the statements prescribed herein shall be published.

The Monetary Board may allow the posting of the financial statements of a bank, quasi-bank or trust entity in public places it may determine, in lieu of the publication required in the preceding paragraph, when warranted by the circumstances.

Additionally, banks shall make available to the public in such form and manner as the Bangko Sentral may prescribe the complete set of its audited financial statements as well as such other relevant information including those on enterprises majority-owned or controlled by the bank, that will inform the public of the true financial condition of a bank as of any given time.

In periods of national and/or local emergency or of imminent panic which directly threaten monetary and banking stability, the Monetary Board, by a vote of at least five (5) of its members, in special cases and upon application of the bank, quasi-bank or trust entity, may allow such bank, quasi-bank or trust entity to defer for a stated period of time the publication of the statement of financial condition required herein. (n)

SECTION 62. Publication of Capital Stock. — A bank, quasi-bank or trust entity incorporated under the laws of the Philippines shall not publish the amount of its authorized or subscribed capital stock without indicating at the same time and with equal prominence, the amount of its capital actually paid up.

No branch of any foreign bank doing business in the Philippines shall in any way announce the amount of the capital and surplus of its head office, or of the bank in its entirety without indicating at the same time and with equal prominence the amount of the capital, if any, definitely assigned to such branch. In case no capital has been definitely assigned to such branch, such fact shall be stated in, and shall form part of the publication. (82)

SECTION 63. Settlement of Disputes. — The provisions of any law to the contrary notwithstanding, the Bangko Sentral shall be consulted by other government agencies or instrumentalities in actions or proceedings initiated by or brought before them involving controversies in banks, quasi-banks or trust entities arising out of and involving relations between and among their directors, officers or

stockholders, as well as disputes between any or all of them and the bank, quasi-bank or trust entity of which they are directors, officers or stockholders. (n)

SECTION 64. Unauthorized Advertisement or Business Representation. — No person, association, or corporation unless duly authorized to engage in the business of a bank, quasi-bank, trust entity, or savings and loan association as defined in this Act, or other banking laws, shall advertise or hold itself out as being engaged in the business of such bank, quasi-bank, trust entity, or association, or use in connection with its business title, the word or words "bank", "banking", "banker", "quasi-bank", "quasi-banking", "quasi-banker", "savings and loan association", "trust corporation", "trust company" or words of similar import or transact in any manner the business of any such bank, corporation or association. (6)

SECTION 65. Service Fees. — The Bangko Sentral may charge equitable rates, commissions or fees, as may be prescribed by the Monetary Board for supervision, examination and other services which it renders under this Act. (n)

SECTION 66. Penalty for Violation of this Act. — Unless otherwise herein provided, the violation of any of the provisions of this Act shall be subject to Sections 34, 35, 36 and 37 of the New Central Bank Act. If the offender is a director or officer of a bank, quasi-bank or trust entity, the Monetary Board may also suspend or remove such director or officer. If the violation is committed by a corporation, such corporation may be dissolved by quo warranto proceedings instituted by the Solicitor General. (87)

CHAPTER V PLACEMENT UNDER CONSERVATORSHIP

SECTION 67. Conservatorship. — The grounds and procedures for placing a bank under conservatorship, as well as, the powers and duties of the conservator appointed for the bank shall be governed by the provisions of Section 29 and the last two paragraphs of Section 30 of the New Central Bank Act: Provided, That this Section shall also apply to conservatorship proceedings of quasi-banks. (n)

CHAPTER VI CESSATION OF BANKING BUSINESS

SECTION 68. Voluntary Liquidation. — In case of the voluntary liquidation of any bank organized under the laws of the Philippines, or of any branch or office in the Philippines of a foreign bank, written notice of such liquidation shall be sent to the Monetary Board before such liquidation is undertaken, and the Monetary Board shall have the right to intervene and take such steps as may be necessary to protect the interests of creditors. (86)

SECTION 69. Receivership and Involuntary Liquidation. — The grounds and procedures for placing a bank under receivership or liquidation, as well as the powers and duties of the receiver or liquidator appointed for the bank shall be governed by the provisions of Sections 30, 31, 32, and 33 of the New Central Bank Act: Provided, That the petitioner or plaintiff files with the clerk or judge of the court in which the action is pending a bond, executed in favor of the Bangko Sentral, in an amount to be fixed by the court. This Section shall also apply to the extent possible to the receivership and liquidation proceedings of quasi-banks. (n)

SECTION 70. Penalty for Transactions After a Bank Becomes Insolvent. — Any director or officer of any bank declared insolvent or placed under receivership by the Monetary Board who refuses to turn over the bank's records and assets to the designated receivers, or who tampers with banks records, or who appropriates for himself or another party or destroys or causes the misappropriation and

destruction of the bank's assets, or who receives or permits or causes to be received in said bank any deposit, collection of loans and/or receivables, or who pays out or permits or causes to be paid out any funds of said bank, or who transfers or permits or causes to be transferred any securities or property of said bank shall be subject to the penal provisions of the New Central Bank Act. (85a)

CHAPTER VII LAWS GOVERNING OTHER TYPES OF BANKS

SECTION 71. Other Banking Laws. — The organization, ownership and capital requirements, powers, supervision and general conduct of business of thrift banks, rural banks and cooperative banks shall be governed by the provisions of the Thrift Banks Act, the Rural Banks Act, and the Cooperative Code, respectively.

The organization, ownership and capital requirements, powers, supervision and general conduct of business of Islamic banks shall be governed by special laws.

The provisions of this Act, however, insofar as they are not in conflict with the provisions of the Thrift Banks Act, the Rural Banks Act, and the Cooperative Code shall likewise apply to thrift banks, rural banks, and cooperative banks, respectively. However, for purposes of prescribing the minimum ratio which the net worth of a thrift bank must bear to its total risk assets, the provisions of Section 33 of this Act shall govern. (n)

CHAPTER VIII FOREIGN BANKS

SECTION 72. Transacting Business in the Philippines. — The entry of foreign banks in the Philippines through the establishment of branches shall be governed by the provisions of the Foreign Banks Liberalization Act.

The conduct of offshore banking business in the Philippines shall be governed by the provisions of the Presidential Decree No. 1034, otherwise known as the "Offshore Banking System Decree." (14a)

SECTION 73. Acquisition of Voting Stock in a Domestic Bank. — Within seven (7) years from the effectivity of this Act and subject to guidelines issued pursuant to the Foreign Banks Liberalization Act, the Monetary Board may authorize a foreign bank to acquire up to one hundred percent (100%) of the voting stock of only one (1) bank organized under the laws of the Republic of the Philippines.

Within the same period, the Monetary Board may authorize any foreign bank, which prior to the effectivity of this Act availed itself of the privilege to acquire up to sixty percent (60%) of the voting stock of a bank under the Foreign Banks Liberalization Act and the Thrift Banks Act, to further acquire voting shares of such bank to the extent necessary for it to own one hundred percent (100%) of the voting stock thereof.

In the exercise of this authority, the Monetary Board shall adopt measures as may be necessary to ensure that at all times the control of seventy percent (70%) of the resources or assets of the entire banking system is held by banks which are at least majority-owned by Filipinos.

Any right, privilege or incentive granted to a foreign bank under this Section shall be equally enjoyed by and extended under the same conditions to banks organized under the laws of the Republic of the Philippines. (Secs. 2 and 3, RA 7721)

SECTION 74. Local Branches of Foreign Banks. — In the case of a foreign bank which has more than one (1) branch in the Philippines, all such branches shall be treated as one (1) unit for the purpose of this Act, and all references to the Philippine branches of foreign banks shall be held to refer to such units. (68)

SECTION 75. Head Office Guarantee. — In order to provide effective protection of the interests of the depositors and other creditors of Philippine branches of a foreign bank, the head office of such branches shall fully guarantee the prompt payment of all liabilities of its Philippine branch. (69)

Residents and citizens of the Philippines who are creditors of a branch in the Philippines of a foreign bank shall have preferential rights to the assets of such branch in accordance with existing laws. (19)

SECTION 76. Summons and Legal Process. — Summons and legal process served upon the Philippine agent or head of any foreign bank designated to accept service thereof shall give jurisdiction to the courts over such bank, and service of notices on such agent or head shall be as binding upon the bank which he represents as if made upon the bank itself.

Should the authority of such agent or head to accept service of summons and legal processes for the bank or notice to it be revoked, or should such agent or head become mentally incompetent or otherwise unable to accept service while exercising such authority, it shall be the duty of the bank to name and designate promptly another agent or head upon whom service of summons and processes in legal proceedings against the bank and of notices affecting the bank may be made, and to file with the Securities and Exchange Commission a duly authenticated nomination of such agent.

In the absence of the agent or head or should there be no person authorized by the bank upon whom service of summons, processes and all legal notices may be made, service of summons, processes and legal notices may be made upon the Bangko Sentral Deputy Governor In-Charge of the supervising and examining departments and such service shall be as effective as if made upon the bank or its duly authorized agent or head.

In case of service for the bank upon the Bangko Sentral Deputy Governor In-Charge of the supervising and examining departments, the said Deputy Governor shall register and transmit by mail to the president or the secretary of the bank at its head or principal office a copy, duly certified by him, of the summons, process, or notice. The sending of such copy of the summons, process, or notice shall be a necessary part of the services and shall complete the service. The registry receipt of mailing shall be prima facie evidence of the transmission of the summons, process or notice. All costs necessarily incurred by the said Deputy Governor for the making and mailing and sending of a copy of the summons, process, or notice to the president or the secretary of the bank at its head or principal office shall be paid in advance by the party at whose instance the service is made. (17)

SECTION 77. Laws Applicable. — In all matters not specifically covered by special provisions applicable only to a foreign bank or its branches and other offices in the Philippines, any foreign bank licensed to do business in the Philippines shall be bound by the provisions of this Act, all other laws, rules and regulations applicable to banks organized under the laws of the Philippines of the same class, except those that provide for the creation, formation, organization or dissolution of corporations or for the fixing of the relations, liabilities, responsibilities, or duties of stockholders, members, directors or officers of corporations to each other or to the corporation. (18)

SECTION 78. Revocation of License of a Foreign Bank. — The Monetary Board may revoke the license to transact business in the Philippines of any foreign bank, if it finds that the foreign bank is insolvent or in imminent danger thereof or that its continuance in business will involve probable loss to those transacting business with it. After the revocation of its license, it shall be unlawful for any such

foreign bank to transact business in the Philippines unless its license is renewed or reissued. After the revocation of such license, the Bangko Sentral shall take the necessary action to protect the creditors of such foreign bank and the public. The provisions of the New Central Bank Act on sanctions and penalties shall likewise be applicable. (16)

CHAPTER IX TRUST OPERATIONS

SECTION 79. Authority to Engage in Trust Business. — Only a stock corporation or a person duly authorized by the Monetary Board to engage in trust business shall act as a trustee or administer any trust or hold property in trust or on deposit for the use, benefit, or behoof of others. For purposes of this Act, such a corporation shall be referred to as a trust entity. (56a; 57a)

SECTION 80. Conduct of Trust Business. — A trust entity shall administer the funds or property under its custody with the diligence that a prudent man would exercise in the conduct of an enterprise of a like character and with similar aims.

No trust entity shall, for the account of the trustor or the beneficiary of the trust, purchase or acquire property from, or sell, transfer, assign or lend money or property to, or purchase debt instruments of, any of the departments, directors, officers, stockholders, or employees of the trust entity, relatives within the first degree of consanguinity or affinity, or the related interests, of such directors, officers and stockholders, unless the transaction is specifically authorized by the trustor and the relationship of the trustee and the other party involved in the transaction is fully disclosed to the trustor or beneficiary of the trust prior to the transaction.

The Monetary Board shall promulgate such rules and regulations as may be necessary to prevent circumvention of this prohibition or the evasion of the responsibility herein imposed on a trust entity. (56)

SECTION 81. Registration of Articles of Incorporation and By-Laws of a Trust Entity. — The Securities and Exchange Commission shall not register the articles of incorporation and by-laws or any amendment thereto, of any trust entity, unless accompanied by a certificate of authority issued by the Bangko Sentral. (n)

SECTION 82. Minimum Capitalization. — A trust entity, before it can engage in trust or other fiduciary business, shall comply with the minimum paid-in capital requirement which will be determined by the Monetary Board. (n)

SECTION 83. Powers of a Trust Entity. — A trust entity, in addition to the general powers incident to corporations, shall have the power to:

- 83.1. Act as trustee on any mortgage or bond issued by any municipality, corporation, or any body politic and to accept and execute any trust consistent with law;
- 83.2. Act under the order or appointment of any court as guardian, receiver, trustee, or depository of the estate of any minor or other incompetent person, and as receiver and depository of any moneys paid into court by parties to any legal proceedings and of property of any kind which may be brought under the jurisdiction of the court;
- 83.3. Act as the executor of any will when it is named the executor thereof;
- 83.4. Act as administrator of the estate of any deceased person, with the will annexed, or as administrator of the estate of any deceased person when there is no will;

- 83.5. Accept and execute any trust for the holding, management, and administration of any estate, real or personal, and the rents, issues and profits thereof; and
- 83.6. Establish and manage common trust funds, subject to such rules and regulations as may be prescribed by the Monetary Board. (58)

SECTION 84. Deposit for the Faithful Performance of Trust Duties. — Before transacting trust business, every trust entity shall deposit with the Bangko Sentral as security for the faithful performance of its trust duties, cash or securities approved by the Monetary Board in an amount equal to not less than Five hundred thousand pesos (P500,000.00) or such higher amount as may be fixed by the Monetary Board: Provided, however, That the Monetary Board shall require every trust entity to increase the amount of its cash or securities on deposit with the Bangko Sentral whenever in its judgment such increase is necessary by reason of the trust business of such entity: Provided, further, That the paid-in capital and surplus of such entity must be at least equal to the amount required to be deposited with the Bangko Sentral in accordance with the provisions of this paragraph. Should the capital and surplus fall below said amount, the Monetary Board shall have the same authority as that granted to it under the provisions of the fifth paragraph of Section 34 of this Act.

A trust entity so long as it shall continue to be solvent and comply with laws or regulations shall have the right to collect the interest earned on such securities deposited with the Bangko Sentral and, from time to time, with the approval of the Bangko Sentral, to exchange the securities for others. If the trust entity fails to comply with any law or regulation, the Bangko Sentral shall retain such interest on the securities deposited with it for the benefit of rightful claimants. All claims arising out of the trust business of a trust entity shall have priority over all other claims as regards the cash or securities deposited as above provided. The Monetary Board may not permit the cash or securities deposited in accordance with the provisions of this Section to be reduced below the prescribed minimum amount until the depositing entity shall discontinue its trust business and shall satisfy the Monetary Board that it has complied with all its obligations in connection with such business. (65a)

SECTION 85. Bond of Certain Persons for the Faithful Performance of Duties. — Before an executor, administrator, guardian, trustee, receiver or depositary appointed by the court enters upon the execution of his duties, he shall, upon order of the court, file a bond in such sum, as the court may direct.

Upon the application of any executor, administrator, guardian, trustee, receiver, depositary or any other person in interest, the court may, after notice and hearing, order that the subject matter of the trust or any part thereof be deposited with a trust entity. Upon presentation of proof to the court that the subject matter of the trust has been deposited with a trust entity, the court may order that the bond given by such persons for the faithful performance of their duties be reduced to such sums as it may deem proper: Provided, however, That the reduced bond shall be sufficient to secure adequately the proper administration and care of any property remaining under the control of such persons and the proper accounting for such property.

Property deposited with any trust entity in conformity with this Section shall be held by such entity under the orders and direction of the court. (59)

SECTION 86. Exemption of Trust Entity from Bond Requirement. — No bond or other security shall be required by the court from a trust entity for the faithful performance of its duties as court-appointed trustee, executor, administrator, guardian, receiver, or depositary. However, the court may, upon proper application with it showing special cause therefor, require the trust entity to post a bond or other security for the protection of funds or property confided to such entity. (59)

SECTION 87. Separation of Trust Business from General Business. — The trust business and all funds, properties or securities received by any trust entity as executor, administrator, guardian, trustee, receiver, or depositary shall be kept separate and distinct from the general business including all other funds, properties, and assets of such trust entity. The accounts of all such funds, properties, or

securities shall likewise be kept separate and distinct from the accounts of the general business of the trust entity. (61)

SECTION 88. Investment Limitations of a Trust Entity. — Unless otherwise directed by the instrument creating the trust, the lending and investment of funds and other assets acquired by a trust entity as executor, administrator, guardian, trustee, receiver or depositary of the estate of any minor or other incompetent person shall be limited to loans or investments as may be prescribed by law, the Monetary Board or any court of competent jurisdiction. (63a)

SECTION 89. Real Estate Acquired by a Trust Entity. — Unless otherwise specifically directed by the trustor or the nature of the trust, real estate acquired by a trust entity in whatever manner and for whatever purpose, shall likewise be governed by the relevant provisions of Section 52 of this Act. (64a)

SECTION 90. Investment of Non-Trust Funds. — The investment of funds other than trust funds of a trust entity which is a bank, financing company or an investment house shall be governed by the relevant provisions of this Act and other applicable laws. (64)

SECTION 91. Sanctions and Penalties. — A trust entity or any of its officers and directors found to have willfully violated any pertinent provisions of this Act, shall be subject to the sanctions and penalties provided under Section 66 of this Act as well as Sections 36 and 37 of the New Central Bank Act. (63)

SECTION 92. Exemption of Trust Assets from Claims. — No assets held by a trust entity in its capacity as trustee shall be subject to any claims other than those of the parties interested in the specific trusts. (65)

SECTION 93. Establishment of Branches of a Trust Entity. — The ordinary business of a trust entity shall be transacted at the place of business specified in its articles of incorporation. Such trust entity may, with prior approval of the Monetary Board, establish branches in the Philippines, and the said entity shall be responsible for all business conducted in such branches to the same extent and in the same manner as though such business had all been conducted in the head office.

For the purpose of this Act, the trust entity and its branches shall be treated as one unit. (67)

CHAPTER X FINAL PROVISIONS

SECTION 94. Phase Out of Bangko Sentral Powers Over Building and Loan Associations. — Within a period of three (3) years from the effectivity of this Act, the Bangko Sentral shall phase out and transfer its supervising and regulatory powers over building and loan associations to the Home Insurance and Guaranty Corporation which shall assume the same. Until otherwise provided by law, building and loan associations shall continue to be governed by Sections 39 to 55, Chapter VI of the General Banking Act, as amended, including such rules and regulations issued pursuant thereto. Upon assumption by the Home Insurance and Guaranty Corporation of supervising and regulatory powers over building and loan associations, all references in Sections 39 to 55 of the General Banking Act, as amended, to the Bangko Sentral and the Monetary Board shall be deemed to refer to the Home Insurance and Guaranty Corporation and its board of directors, respectively. (n)

SECTION 95. Repealing Clause. — Except as may be provided for in Sections 34 and 94 of this Act, the General Banking Act, as amended, and the provisions of any other law, special charters, rule or regulation issued pursuant to said General Banking Act, as amended, or parts thereof, which may be inconsistent with the provisions of this Act are hereby repealed. The provisions of paragraph 8, Section 8, Republic Act No. 3591, as amended by Republic Act No. 7400, are likewise repealed. (90a)

SECTION 96. Separability Clause. — If any provision or section of this Act or the application thereof to any person or circumstance is held invalid, the other provisions or sections of this Act, and the application of such provision or section to other persons or circumstances, shall not be affected thereby. (n)

SECTION 97. Effectivity Clause. — This Act shall take effect fifteen (15) days following its publication in the Official Gazette or in two (2) national newspapers of general circulation. (91)

Approved,

MANUEL B. VILLAR JR.
*Speaker of the House
of Representatives*

FRANKLIN M. DRILON
President of the Senate

This Act, which is a consolidation of Senate Bill No. 1519 and House Bill No. 6814, was finally passed by the Senate and the House of Representatives on April 12, 2000.

ROBERTO P. NAZARENO
*Secretary General
House of Representatives*

OSCAR G. YABES
Secretary of the Senate

Approved:

JOSEPH EJERCITO ESTRADA

Approved: May 23, 2000

Republic of the Philippines
Congress of the Philippines
Metro Manila

Twelfth Congress
Second Regular Session

Begun and held in Metro Manila, on Monday, the twenty-second day of July, two thousand two.

Republic Act No. 9178

November 13, 2002

**AN ACT TO PROMOTE THE ESTABLISHMENT OF BARANGAY MICRO
BUSINESS ENTERPRISES (BMBEs), PROVIDING INCENTIVES AND
BENEFITS THEREFOR, AND FOR OTHER PURPOSES.**

Be it enacted by the Senate and House of Representatives of the Philippines in Congress assembled.

PRELIMINARY PROVISIONS

Section 1. *Short Title* – This Act shall be known as the "Barangay Micro Business Enterprises (BMBE's) Act of 2002."

Section 2. *Declaration of Policy* – It is hereby declared to be the policy of the State to hasten the country's economic development by encouraging the formation and growth of barangay micro business enterprises which effectively serve as seedbeds of Filipino entrepreneurial talents, and intergranting those in the informal sector with the mainstream economy, through the rationalization of bureaucratic restrictions, the active granting of incentives and benefits to generate much-needed employment and alleviate poverty.

Section 3. *Definition of Terms* – As used in this Act, the following terms shall mean:

- (a) "Barangay Micro Business Enterprise," hereinafter referred to as BMBE, refers to any business entity or enterprise engaged in the production, processing or manufacturing of products or commodities, including agro-processing, trading and services, whose total assets including those arising from loans but exclusive of the land on which the particular business entity's office, plant and equipment are situated, shall not be more than Three Million Pesos (P3,000,000.00) The Above definition shall be subjected to review and upward adjustment by the

SMED Council, as mandated under Republic Act No. 6977, as amended by Republic Act No. 8289.

For the purpose of this Act, "service" shall exclude those rendered by any one, who is duly licensed government after having passed a government licensure examination, in connection with the exercise of one's profession.

(b) "Certificate of Authority" is the certificate issued granting the authority to the registered BMBE to operate and be entitled to the benefits and privileges accorded thereto.

(c) "Assets" refers to all kinds of properties, real or personal, owned by the BMBE and used for the conduct of its business as defined by the SMED Council: *Provided*, That for the purpose of exemption from taxes and fees under this Act, this term shall mean all kinds of properties, real or personal, owned and/or used by the BMBE for the conduct of its business as defined by the SMED Council.

(d) "Registration" refers to the inclusion of BMBE in the BMBE Registry of a city or municipality.

(e) "Financing" refers to all borrowings of the BMBE from all sources after registration.

REGISTRATION AND OPERATION OF BMBE

Section 4. *Registration and Fees* - The Office of the Treasurer of each city or municipality shall register the BMBE's and issue a Certificate of Authority to enable the BMBE to avail of the benefits under this Act. Any such applications shall be processed within fifteen (15) working days upon submission of complete documents. Otherwise, the BMBEs shall be deemed registered. The Municipal or City Mayor may appoint a BMBE Registration Officer who shall be under the Office of the Treasurer. Local government units (LGU's) are encouraged to establish a One-Stop-business Registration Center to handle the efficient registration and processing of permits/licenses of BMBEs. Likewise, LGUs shall make a periodic evaluation of the BMBE's financial status for monitoring and reporting purposes.

The LGUs shall issue the Certificate of Authority promptly and free of charge. However, to defray the administrative costs of registering and monitoring the BMBEs, the LGUs may charge a fee renewal.

The Certificate of Authority shall be effective for a period of two (2) years, renewable for a period of two (2) years for every renewal.

As much as possible, BMBEs shall be subject to minimal bureaucratic requirements and reasonable fees and charges.

Section 5. *Who are Eligible to Register* – Any person, natural or juridical, or cooperative, or association, having the qualifications as defined in Section 3(a) hereof may apply for registration as BMBE.

Section 6. *Transfer of Ownership* - The BMBE shall report to the city or municipality of any changer in the status of its ownership structure, and shall surrender the original copy of the BMBE Certificate of Authority for notation of the transfer.

INCENTIVES AND BENEFITS

Section 7. *Exemption from Taxes and Fees* – All BMBEs shall be exempt from tax for income arising from the operations of the enterprise.

The LGUs are encouraged either to reduce the amount of local taxes, fees and charges imposed or to exempt BMBEs from local taxes, fees and charges.

Section 8. *Exemption from the Coverage of the Minimum Wage Law* – The BMBEs shall be exempt from the coverage of the Minimum Wage Law: *Provided*, That all employees covered under this Act shall be entitled to the same benefits given to any regular employee such as social security and healthcare benefits.

Section 9. *Credit Delivery* – upon the approval of this Act, the Land Bank of the Philippines (LBP), the Development Bank of the Philippines (DBP), the Small Business Guarantee and Finance Corporation (SBGFC), and the People's Credit and Finance Corporation (PCFC) shall set up a special credit window that will service the financing needs of BMBEs registered under this Act consistent with the Banko Sentral ng Pilipinas (BSP) policies; rules and regulations. The Government Service Insurance System (GSIS) and Social Security System (SSS) shall likewise set up a special credit window that will serve the financing needs of their respective members who wish to establish a BMBE. The concerned financial institutions (FIs) encouraged to wholesale the funds to accredited private financial institutions including community-based organizations such as credit, cooperatives, non-government organizations (NGOs) and people's organizations, which will in turn, directly provide credit support to BMBEs.

All loans from whatever sources granted to BMBEs under this Act shall be considered as part of alternative compliance to Presidential Decree no. 717,, otherwise known as the Agri-Agra Law, or to Republic Act. No. 6977, known as the Magna Carta for Small and Medium Enterprises, as amended. For purposes of compliance with presidential Decree no. 717 and Republic Act No. 6977, as

amended, loans granted to BMBEs under this Act shall be computed at twice the amount of the face value of the loans.

To minimize the risks in lending to the BMBEs, the SBGFC and the Quedan and Rural Credit Guarantee Corporation (QUEDANCOR) under the Department of Agriculture, in case of agribusiness activities, shall set up a special guarantee window to provide the necessary credit guarantee to BMBEs under their respective guarantee programs.

The LBP, DBP, PCFC, SBGFC, SSS, GSIS, and QUEDANCOR shall annually report to the appropriate Committee of Both Houses of Congress on the status of the implementation of this provision.

The BSP shall formulate the rules for the implementation of this provision and shall likewise establish incentive programs to encourage and improve credit delivery to the BMBEs.

Section 10. *Technology Transfer, Production and Management Training, and marketing Assistance* – A BMBE Development Fund shall be set up with an endowment of Three Hundred Million pesos (P300,000,000.00) from the Philippine Amusement and Gaming Corporation (PAGCOR) and shall be administered by the SMED Council.

The Department of Trade and Industry (DTI), the Department of Science and Technology (DOST), the university of the Philippines Institute for Small Scale Industries (UP ISSI), Cooperative Development Authority (CDA), Technical Education and Skills Development Authority (TESDA), and Technology and Livelihood Resource Center (TLRC) may avail of the said Fund for technology transfer, production and management training and marketing assistance to BMBEs.

The DTI, in coordination with the private sector and non-government organization (NGOs), shall explore the possibilities of linking or matching-up BMBEs with small, medium and large enterprises and likewise establish incentives therefor.

The DTI, in behalf of the DOST, UP ISSI, CDA, TESDA and TLRC shall be required to furnish the appropriate Committees of both Houses of Congress a yearly report on the development and accomplishments of their projects and programs in relation to technology transfer, production and management training and marketing assistance extended to BMBEs.

Section 11. *Trade and Investment Promotions* – The data gathered from business registration shall be made accessible to and shall be utilized by private sector organizations and non-government organizations for purposes of business matching, trade and investment promotion.

INFORMATION DISSEMINATION

Section 12. *Information Dissemination* - The Philippine Information Agency (PIA), in accordance with the Department of Labor and Employment (DOLE), the DILG and the DTI, shall ensure the proper and adequate information dissemination of the contents and benefits of this Act to the general public especially to its intended beneficiaries specifically in the barangay level.

PENALTY

Section 13. *Penalty* - Any person who shall willfully violates any provision of this Act or who shall in any manner commit any act to defeat any provisions of this Act shall, upon conviction, be punished by a fine of not less than twenty-five Thousand Pesos (P25,000.00) but not more than Fifty Thousand Pesos (P50,000.00) and suffer imprisonment of not less than six (6) months but not more than two (2) years.

In case of non-compliance with the provisions of Section 9 of this Act, the BSP shall impose administrative sanctions and other penalties on the concerned government financial institutions, including a fine of not less than Five Hundred Thousand Pesos (P500,000.00)

MISCELLANEOUS PROVISIONS

Section 14. *Annual Report* – The DILG, DTI, and BSP shall submit an annual report to the Congress on the status of the implementation of this Act.

Section 15. *Implementing Rules and Regulations* – The Secretary of the Department of Trade and Industry, in consultation with the Secretaries of the DILG, DOF, and the BSP Governor shall formulate the necessary rules and regulations to implement the provisions of this Act within ninety (90) days after its approval. The rules and regulations issued pursuant to this section shall take effect fifteen (15) days after its publication in a newspaper of general circulation.

Section 16. *Separably Clause* - If any provision or part hereof, is held invalid or unconstitutional, the remainder of the law or the provision not otherwise affected shall remain valid and subsisting.

Section 17. *Repealing Clause* – Existing laws, presidential decrees, executive orders, proclamations or administrative regulations that are inconsistent with the provisions of this Act are hereby amended, modified, superseded or repealed accordingly.

Section 18. *Effectivity* – This Act shall take effect fifteen (15) days after its publication in the *Office Gazette* or in at least two (2) newspaper of general circulation.

Approved,

FRANKLIN DRILON
President of the Senate

JOSE DE VENECIA JR.
Speaker of the House of
Representatives

This Act, which is a consolidation of Senate Bill No. 1855 and House Bill No. 4871 was finally passed by the Senate and the House of Representatives on October 24, 2002 and October 23, 2002, respectively.

OSCAR G. YABES
Secretary of Senate

ROBERTO P. NAZARENO
Secretary General
House of Representatives

Approved: November 13, 2002

GLORIA MACAPAGAL-ARROYO
President of the Philippines

DEPARTMENT TRADE AND INDUSTRY

ADMINISTRATIVE ORDER NO. 01
Series of 2003.

SUBJECT: Implementing Rules and Regulations of R.A. 9178, Otherwise known as the "Barangay Micro Business Enterprises (BMBEs) Act of 2002"

Pursuant to Sec. 15 of R.A. 9178, otherwise known as the "Barangay Micro Business Enterprises (BMBEs) Act of 2002", and after consultation with the Department of the Interior and Local Government (DILG), the Department of Finance (DOF) and the Bangko Sentral ng Pilipinas (BSP), and other concerned agencies, the following Rules and Regulations governing BMBEs are hereby prescribed for the compliance, information and guidance of all concerned.

I. PRELIMINARY PROVISIONS

Sec. 1. **Declaration of Policy.** As stated in Sec. 2 of RA 9178, it is the policy of the State to hasten the country's economic development by encouraging the formation and growth of barangay micro business enterprises which effectively serve as seedbeds of Filipino entrepreneurial talents, and integrating those in the informal sector with the mainstream economy, through the rationalization of bureaucratic restrictions, the active intervention of the government specially in the local level, and the granting of incentives and benefits to generate much-needed employment and alleviate poverty.

Sec. 2. **Definition of Terms.** - When used herein, the term:

- a. Act- shall refer to the "Barangay Micro Business Enterprises Act of 2002".
- b. Barangay Micro Business Enterprise (BMBE) - as defined in Sec. 3a of the Act, shall refer to any business entity or enterprise engaged in the production, processing or manufacturing of products or commodities, including agro-processing, trading and services, whose total assets including those arising from loans but exclusive of the land on which the particular business entity's office, plant and equipment are situated, shall not be more than Three Million Pesos (P3,000,000.00) subject to review and upward adjustment by the SMED Council, as mandated under Republic Act 6977, as amended by Republic Act 8289. A BMBE shall include any individual owning such business entity/enterprise, partnership, cooperative, corporation, association or other entity incorporated and/or organized and existing under Philippine laws; and registered with the office of the treasurer of a city or municipality in accordance with this implementing rules and regulations.

"Services" shall exclude those rendered by any one, who is duly licensed by the government after having passed a government licensure examination, in connection with the exercise of one's profession as stated in Paragraph 2 Sec. 3(a), RA 9178.

- c. Certificate of Authority (CA) - shall refer to the certificate issued to an applicant authorizing the same to operate as a BMBE and to be entitled to the benefits and privileges accorded to a registered BMBE.
- d. Assets - shall refer to all kinds of properties, real or personal, owned by the BMBE and used for the conduct of its business as defined by the SMED Council: Provided, That for the purpose of exemption from taxes and fees under the Act, this term shall mean all kinds of properties, real or personal, owned and/or used by the BMBE for the conduct of its business as defined by the SMED Council.
- e. Registration - shall mean the inclusion of a BMBE in the BMBE Registry of a city or municipality.
- f. Financing - shall refer to all borrowings of the BMBE from all sources after registration.

II. REGISTRATION OF BMBE

Sec. 3. **Place of Registration.** - The Office of the Treasurer of each city or municipality shall register BMBEs and issue a Certificate of Authority (CA) to enable the BMBE to avail of incentives under the Act; Provided, That only one Certificate of Authority shall be issued for each BMBE and only by the Office of the Treasurer of the city or municipality that has jurisdiction over the principal place of business of the BMBE.

Sec. 4. **Who are eligible to register.** - Any person, natural or juridical, cooperative or association, having the qualifications herein below enumerated, may apply for registration as BMBE:

- a. have an asset size of not more than three million pesos (P3,000,000.00) excluding land, before applying for BMBE registration; and
- b. engaged in the business activities as defined in Sec. 2(b) of this IRR.

Sec. 5. **Requirements for Registration.** The applicant for BMBE registration shall submit the duly filled up application (BMBE Form 01) in triplicate, signed by the owner or manager of the entity applying for registration.

Sec. 6. **Procedures for Registration.** The following are the procedures when applying for registration as BMBE:

- a. an applicant for BMBE shall go to the Office of the Municipal or City Treasurer where the business is located;
- b. the applicant shall accomplish BMBE Form 01 in triplicate and submit to the Office of the Municipal or City Treasurer;
- c. the Municipal or City Treasurer evaluates the application. Application shall be processed within fifteen (15) working days upon submission of complete documents. Otherwise, the BMBEs shall be deemed registered; and a registered BMBE shall be issued a CA as proof of registration, which will be effective for a period of two (2) years, renewable for a period of two (2) years for every renewal.

Sec. 7. **Fees and Charges.** - The LGUs shall issue the CA promptly and free of charge. However, to defray the administrative costs of registering and monitoring the BMBEs, the LGU may charge a fee not exceeding One Thousand Pesos (P1,000.00).

Sec. 8. **Transfer of Ownership.** - The BMBE shall report to the city or municipality of any change in the status of its ownership structure, and shall surrender the original copy of the BMBE Certificate of Authority for notation of the transfer.

III. INCENTIVES AND BENEFITS

Sec. 9. **Exemption from taxes and fees.** - All BMBEs shall be exempted from income tax for income arising from the operation of the enterprise.

The Local Government Units (LGUs) are encouraged either to reduce the amount of local taxes, fees and charges imposed or to exempt the BMBE from local taxes, fees and charges.

Sec. 10. **Exemption from the Coverage of the Minimum Wage Law.** The BMBEs shall be exempt from the coverage of the Minimum Wage Law: Provided, That all employees covered under the Act shall be entitled to the same benefits given to any regular employee such as social security and healthcare benefits.

Sec. 11. **Credit Delivery.** As stated in Sec. 9 of the Act, the Land Bank of the Philippines (LBP), the Development Bank of the Philippines (DBP), Small Business Guarantee and Finance Corporation (SBGFC), and People's Credit and Finance Corporation (PCFC) shall set up a special credit window that will service the financing needs of BMBEs registered under the Act consistent with the BSP policies, rules and regulations. The Government Service Insurance System (GSIS) and Social Security System (SSS) shall likewise set up a special credit window that will serve the financing needs of their respective members who wish to establish a BMBE. The concerned financial institutions (FIs) are encouraged to wholesale the funds to accredited private financial institutions including community-based organizations such as cooperatives, non-government organizations (NGOs) and people's organizations, which will in turn, directly provide credit support to BMBEs.

All loans from whatever sources granted to BMBEs under the Act shall be considered as part of alternative compliance to Presidential Decree No. 717, otherwise known as the Agri-Agra Law, or to Republic Act No. 6977, otherwise known as the Magna Carta for Small and Medium Enterprises, as amended. For purposes of compliance with Presidential Decree No. 717 and Republic Act No. 6977, as amended, loans granted to BMBEs under the Act shall be computed at twice the amount of the face value of the loans.

Any existing laws to the contrary notwithstanding, interests, commissions and discounts derived from the loans by the LBP, DBP, PCFC and SBGFC granted to BMBEs as well as loans extended by the GSIS and SSS to their respective member- employees under the Act shall be exempt from gross receipts tax (GRT).

To minimize the risks in lending to the BMBEs, the SBGFC and the Quedan and Rural Credit Guarantee Corporation (QUEDANCOR) under the Department of Agriculture, in case of agribusiness activities, shall set up a special guarantee window to provide the necessary credit guarantee to BMBEs under their respective guarantee programs.

The LBP, DBP, PCFC, SBGFC, SSS, GSIS, and QUEDANCOR shall annually report to the appropriate Committees of both Houses of Congress on the status of the implementation of this provision.

The BSP shall formulate the rules for the implementation of this provision and shall likewise establish incentive programs to encourage and improve credit delivery to the BMBEs.

Sec. 12. **Technology Transfer, Production and Management Training, and Marketing Assistance.** BMBEs can avail of technology transfer, production, management training programs and marketing assistance of the DTI, DOST, UP-ISSI, CDA, TESDA, TLRC and other concerned agencies.

Sec. 13. **BMBE Development Fund.** As stated in Sec. 10 of the Act, a BMBE Development Fund shall be set up with an endowment of Three Hundred Million Pesos (P300,000,000.00) from the PAGCOR and shall be administered by the SMED Council.

The DTI, DOST, UP ISSI, CDA, TESDA, and TLRC may avail of the said Fund for technology transfer, production and management training and marketing assistance to BMBEs.

Sec. 14. **Trade and Investment Promotion.** - The data gathered from business registration shall be made accessible to and shall be utilized by private sector organizations and non-government organizations for purposes of business matching, trade and investment promotion.

Sec. 15. **One-Stop Business Registration Center.** LGUs are encouraged to establish a One-Stop Business Registration to handle the efficient registration and processing of permits/licenses of BMBEs.

IV. INFORMATION DISSEMINATION

Sec. 16. **Information Dissemination.** The Philippine Information Agency (PIA) in coordination with the concerned agencies (DOLE, the DILG, and the DTI) shall ensure the proper and adequate information dissemination of the contents and benefits of the Act to the general public especially to its intended beneficiaries in the barangay level.

V. PENALTY

Sec. 17. **Penalty.** Any person who shall willfully violate any provision of the Act or who shall in any manner commit any act to defeat any provision of the Act shall, upon conviction, be punished by a fine of not less than Twenty-five Thousand Pesos (P25,000.00) but not more than Fifty Thousand Pesos (P50,000.00) and suffer imprisonment of not less than six (6) months but not more than two (2) years.

In case of non-compliance with the provisions of Section 9 of the Act, the BSP shall impose administrative sanctions and other penalties on the concerned government financial institutions, including a fine of not less than Five Hundred Thousand Pesos (P500,000.00).

VI. MISCELLANEOUS PROVISIONS

Sec. 18. **Annual Report.** The DILG, DTI, and BSP shall submit Annual Reports to Congress on the status of the implementation of the Act.

Sec. 19. **Effectivity.** - These rules shall take effect fifteen (15) days after its publication in a newspaper of general circulation.

APPROVED: 07 February 2003.

MAR ROXAS
Secretary of Trade and Industry



Republic of the Philippines
OFFICE OF THE PRESIDENT
COOPERATIVE DEVELOPMENT AUTHORITY

Memorandum Circular No. 02-04
Series of 2002

To : All CDA Department and Regional Directors, Registered/Confirmed Credit and Other Types of Cooperatives with Savings and Credit Services and All Others Concerned

Subject : **Standard Chart of Accounts for Credit and Other Types of Cooperatives with Savings and Credit Services**

Pursuant to Section 3 of Republic Act No. 6939, an Act Creating the Cooperative Development Authority defining its Powers, Functions and Responsibilities, the Authority hereby issues this Memorandum Circular prescribing the use of Standard Chart of Accounts for Credit and Other Types of Cooperatives with Credit Services.

I. Scope

This Circular shall be applied in accounting and reporting of all credit and other types of cooperatives with credit services, duly registered/confirmed by the Cooperative Development Authority pursuant to Chapter XIV of Republic Act No. 6938, otherwise known as the Cooperative Code of the Philippines.

II. Definition of Terms

1. Credit Cooperative

A credit cooperative is financial organization owned and operated by its members with the following objectives: 1) to encourage savings among its members; 2) to create pool of such savings from which loans for productive or provident purposes may be granted to its members; and 3) to provide related services to its members to maximize the benefits from such loans. (Article 111, R.A. 6938)

2. Other Types of Cooperative with Credit Services

Refers to those cooperatives, which are registered as non-credit cooperatives but are engaged in the provision of savings and credit services aside from other businesses.

3. Accounting

Accounting is the art of recording, classifying, summarizing, in a significant manner and

in terms of money, transactions and events which are in part at least of a financial character and interpreting the results thereof.

Accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decision. (SFAS No. 1)

4. Bookkeeping

It is the systematic and chronological recording of all financial transactions that take place in the cooperative. The importance of bookkeeping are as follows: to have a record of whatever changes there are in the financial condition of the credit cooperative; to protect funds; to serve as the guide in the formulation of policies and activities for the coming year; to serve as source of information necessary for the Board to properly set the policies of the cooperative; to serve as basis of reports to members; for management to enable them to run the affairs of the cooperative and for the submission of the financial statements as mandated by the government.

5. Books of Accounts

Set of books where business transactions are recorded and classified. These are classified into books of original entry and of final entry. The books of original entry are the books where entries from source documents are first recorded. These are the cash receipts book; cash disbursements book and general journal. The book of final entry called general ledger is the book where entries in the books of original entry are posted to the corresponding accounts. It is also called a “reference book” of the accounting system where transactions are classified and summarized. This is the source of data for the trial balance and eventually the financial statements.

6. Financial Statements

Financial statements are the means by which the information accumulated and processed in financial accounting is periodically communicated to those who use it. They are designed to serve the needs of a variety of users, particularly owners and creditors. Through the financial accounting process, the myriad and complex effects of the economic activities of a cooperative are accumulated, analyzed, quantified, classified, recorded, summarized and reported as information of two basic types: a) financial condition, which relates to a point in time, and b) financial operations, which relate to a period of time. Notes to the statements, which may explain headings, captions or amounts in the statements or present information that cannot be expressed in terms of money and those descriptions of accounting policies are integral part of the statements.

A. Statement of Financial Condition (balance sheet) presents three major categories: a) assets, b) liabilities, and c) equity, the difference between the total assets and total liabilities. The statement of financial condition at any date presents an indication in conformity with generally accepted accounting principles of the financial status of the cooperative at a particular point in time.

B. Statement of Operation (Statement of Net Surplus) for a period presents the revenues, expenses, gains, losses, and net surplus (net loss) recognized during the period and

thereby presents an indication in conformity with generally accepted accounting principles of the results of the cooperative's service-directed activities during the period. The information presented in the statement of operation is usually considered the most important information provided by financial accounting because the net surplus is a paramount concern to those interested in the economic activities of the cooperative.

C. Statement of Cash Flows is a formal statement summarizing all operating, investing and financing activities of a cooperative. In simple language, the statement of cash flows provided information about cash receipts and cash payments of a cooperative during a period.

III. Objectives and Purposes

The basic purpose of prescribing the standard chart of accounts is to provide quantitative financial information about the credit cooperatives and other types of cooperatives with credit services, specifically, to:

- a) Ensure uniformity and common understanding of accounts;
- b) Guide in the installation of accounting and internal control systems to make cooperative auditable;
- c) Enhance transparency;
- d) Set standards and discipline in measuring the financial safety and soundness;
- e) Facilitate the analysis and evaluation of financial and management performance, monitoring, supervision and business linkages.

IV. Chart of Accounts with Description

Standard Chart of Accounts for Credit and Other Types of Cooperatives with Credit Services

Account Title		Brief Definition/Description
ASSET ACCOUNTS <i>Economic resources of a cooperative that are recognized and measured in conformity with generally accepted accounting principles.</i>		
CURRENT ASSETS <i>Include cash and other assets that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business, which is usually one year.</i>		
101	Cash on Hand	<i>Money (bills and coins), checks except post dated checks, postal money order (PMO), and demand drafts still in the possession of the cooperative's custodian. This includes cash items awaiting deposits.</i>
102	Cash in Bank	<i>Money deposited in the bank under the name of the cooperative, i.e. savings, current, time deposits, and combo-account. A separate ledger account is used to keep track of deposits made in the bank.</i>

Account Title		Brief Definition/Description
103	Petty Cash Fund	<p>Limited amount of money set aside for small expenditures, maintained under an imprest system.</p> <p>It is a revolving cash fund, withdrawn from the general cash account and made available for small purchases and expenditures such as: stationery and supplies, taxi fares or staff meals.</p>
104	Revolving Fund	<p>The amount set aside to pay/meet members' withdrawals, loan proceeds and other operations as may be determined by the cooperative, except encashment of other checks.</p> <p>Like the Petty Cash Fund, the Revolving Fund is maintained under an imprest system, that is, the total amount of expenditures, properly supported by documents must match the amount of the fund.</p>
112	Cash Advances to Officers and Employees	Duly approved cash advances for official business to officers and employees subject to immediate liquidation.
140	Short Term Investment	Investment in marketable securities, government bonds, and other mutual funds that are readily convertible into cash.
150	Loans Receivable – Current	The total loans granted to members, which are not yet due.
151	Loans Receivable – Restructured	Collectibles from the member-borrowers whose loan accounts were restructured upon full payment of interests due.
152	Loans Receivable – Past Due	<p>Total collectibles from past due loans of member-borrowers. Aging of loans receivable should be prepared to determine how much are the past due loans.</p> <p>The loan shall remain in this account until fully paid or until arrangements are formalized for its renewal/extension/ restructuring or collection/foreclosure.</p>
153	Loans Receivable – Loans in Litigation	<p>Total collectibles from past due loans under legal action. The loan or advance shall remain in this account during the pendency of the legal proceedings and until fully paid/ restructured/foreclosed.</p>
154	Allowance for Probable Losses on Loans	<p>Allowance set aside in the books of the cooperative to provide for possible losses due to uncollectible accounts. This account may also be referred to as Allowance for Doubtful Accounts. This is a contra account to Loans Receivable.</p>
161	Receivable from Accountable Officers and Employees	Total collectibles from shortages and other losses due from accountable officers and employees that are subject to immediate settlement/sanction.
162	Other Receivables	<p>Transactions/adjustments not classified under any of the receivable accounts mentioned. These also represent:</p> <ul style="list-style-type: none"> The amounts currently owed to the cooperative by persons other than the members for services rendered.

Account Title		Brief Definition/Description
		<ul style="list-style-type: none"> Advances to members on account of their expenses not previously covered by deposits such as insurance premiums on properties pledged to the cooperative, taxes and other government imposts, inspection fees, wire charges and other expenses.
170	Unused Office Supplies	Office supplies on hand at the end of the accounting period.
174	Prepaid Expenses	Payments made in advance in exchange for a future benefit usually within one year (e.g., insurance, interest, advertising, rentals, etc.).
LONG TERM INVESTMENTS <i>Investments which the cooperative intends to hold for more than a year.</i>		
182	Long Term Investments – Cooperatives	Equity investments of the cooperative in other cooperatives.
184	Long Term Investments – Government Securities/Bonds	Investments in securities and bonds issued by the government and its instrumentalities.
185	Long Term Investments – Others (Specify)	All other investments not included in the above.
PROPERTY AND EQUIPMENT <i>Include all tangible assets with an estimated useful life beyond one year, are used in the conduct of the business, and not intended for sale in the ordinary course of business (SFAS No. 6).</i>		
191	Land	The cost of the land used for its main operation plus all incidental costs such as title, sales commissions, delinquent taxes, surveying fees, legal fees, etc. All these are reflected in a single cost (fair market value or appraised value if donated). Taxes paid by the cooperative as a contribution to the cost of public improvements (special assessment) are treated as part of the cost of the land.
192	Land Improvements	<p>The cost of depreciable improvement after land acquisition (i.e., pavement, fencing, water system, drainage system, sidewalks and pavements, etc. that are subject to depreciation over their useful life).</p> <p>Land improvements not subject to depreciation are charged to the land account. Examples of these expenditures are cost of surveying, cost of clearing, cost of grading, cost of subdividing, cost of landscaping, etc.</p>
193	Accumulated Depreciation – Land Improvements	Sum of depreciation on land improvements that are set-up periodically against current operation.
196	Building	Cost of the building constructed on the land owned by the cooperative and used for its main operation. Major repairs or improvements that will prolong the life of the building are considered additional cost.

Account Title		Brief Definition/Description
197	Accumulated Depreciation Building	<i>Sum of depreciation on building that are set-up - periodically against current operation.</i>
205	Furniture, Fixtures and Office Equipment	<i>The cost or appraised value or other appropriate value of movable (furniture), immovable (fixtures) properties and office equipment used in the cooperative's ordinary course of business such as desks, chairs, cabinets, computers, etc. including incidental expenses incurred in acquiring them up to the time they are received. Depreciation is determined periodically (monthly, quarterly, etc.) in accordance with generally accepted rates.</i> <i>Furniture, fixtures and office equipment may be acquired through donations and without any cash outlay on the part of the cooperative.</i>
206	Accumulated Depreciation – Furniture, Fixtures and Office Equipment	<i>Sum of depreciation on furniture, fixtures and office equipment that are set-up periodically against current operation.</i>
208	Transportation Equipment	<i>Cost of equipment which are owned by the cooperative such as motorcycles, pick-ups, vans and other vehicles used in transporting goods, services or personnel. This is recorded at cost or appraised value if donated.</i>
209	Accumulated Depreciation-Transportation Equipment	<i>Sum of depreciation on transportation equipment that are set-up periodically against current operation.</i>
210	Leasehold Rights and Improvement	<i>Cost of building and/or improvements made on leased land/ premises including cost of rights paid.</i>
OTHER ASSETS <i>Are assets which do not fit into any of the preceding asset classifications.</i>		
250	Organizational Costs	<i>Expenses incurred prior to the actual operations of the cooperative such as promoting and organizing. This can be amortized over a period not exceeding five (5) years. Among others, these costs are:</i> <i>a. Legal fees in connection with the organization;</i> <i>b. Registration fees;</i> <i>c. Cost of printing share capital certificates and transfer book, seal of the cooperative, etc.; and</i> <i>d. Other cost of services rendered in the formation of the cooperative.</i>
251	Computerization Costs	<i>The cost of acquisition or development of computer programs and other software. This can be amortized over a period not exceeding three (3) years.</i>
252	Other Funds and Deposits	<i>Holdout deposits on guarantee fund given by the cooperative to the funding institutions in compliance with the requirements of certain agreements; the corresponding fund set aside from the reserve, optional fund and any other funds</i>

Account Title		Brief Definition/Description
		<i>that may be set up by the cooperative. This may be in the form of time deposits or other securities. The cooperative has the option to create sub-accounts.</i>
256	Due from Head Office/ Branch/Subsidiary	<i>Receivables from head office/branch or subsidiary.</i>
257	Assets Acquired in Settlement of Loans	<i>Real and personal properties acquired by the cooperative through judicial or extra-judicial settlement of loans. Should the cooperative use such assets in its main operation, the same assets shall be re-classified accordingly.</i>
258	Other Land	<i>Cost of the land owned by the cooperative, which is not used for its main operation.</i>
259	Other Building	<i>Cost of the building owned by the cooperative, which is not used for its main operation.</i>
260	Accumulated Depreciation – Other Building	<i>Sum of depreciation on other building that are set-up periodically against current operation.</i>
261	Miscellaneous Assets	<i>Assets not falling in any of the above categories.</i>
LIABILITY ACCOUNTS		
<i>Economic obligations of a cooperative that are recognized and measured in conformity with generally accepted accounting principles.</i>		
CURRENT LIABILITIES		
<i>Obligations that are reasonably expected to be settled through the use of existing current assets or the creation of other current liabilities in the same statement of condition within the normal operating cycle of the cooperative which is usually one year.</i>		
300	Savings Deposits	<i>Deposits made by members that can be withdrawn anytime at the option of the depositors.</i>
303	Time Deposits	<i>Deposits made by the members in the cooperative over a specified period of time and withdrawable at a pre-determined date.</i>
304	Loans Payable – Short Term	<i>The indebtedness of the cooperative to financial institutions, other cooperatives, or person(s), payable on short-term basis not exceeding one (1) year.</i>
308	SSS/ECC/PhilHealth Premium and Pag-ibig Contributions Payable	<i>Amounts withheld by the cooperative from the compensation income of its employees representing their contribution to SSS, PhilHealth and Pag-ibig agencies. As an employer, the cooperative has its corresponding share of contributions and this should be set up every payroll period.</i>
309	Withholding Tax Payable	<i>All taxes withheld as prescribed by law including the unremitted withholding tax deducted from the employees' salaries representing part of their possible income tax liability to the Bureau of Internal Revenue (BIR).</i>

Account Title		Brief Definition/Description
310	Accrued Expenses	<i>Expenses that have been incurred but not yet paid as of date of statement of financial condition but payable within the next accounting period. This account represents the amount due to creditors/employees for services rendered/received and other expenses already incurred but not yet paid.</i>
311	Interest on Share Capital Payable	<i>Liability of the cooperative to its members for interest on share capital, which can be determined only at the end of every accounting period.</i>
312	Patronage Refund Payable	<i>Liability of the cooperative to its members for patronage refund, which can be determined only at the end of every accounting period.</i>
313	Due to CETF (Apex)	<i>An amount set aside for the education and training fund of an apex organization, which is 50% of the amount allocated, by the cooperative in accordance with the provision of the cooperative's by-laws and the cooperative code. The apex organization may be either a federation or union of which the cooperative is a member (RA 6938, Article 87, 2a).</i>
314	Unearned Income	<i>Income already received but not yet earned.</i>
316	Other Payables	<i>Other liabilities that cannot be classified under any of the preceding current liability accounts.</i>
LONG TERM LIABILITIES <i>Liabilities payable beyond one year.</i>		
320	Loans Payable- Long Term	<i>The indebtedness of the cooperative to financial institutions, other cooperatives, or person(s), payable beyond one year.</i>
321	Revolving Capital Payable	<i>The deferred payment of interest on share capital and patronage refund, which should be agreed upon in the General Assembly.</i>
322	Retirement Fund Payable	<i>Accumulated retirement benefit costs charged against the income of the cooperative over the expected remaining working lives of participating employees.</i>
323	Other Long Term Payables	<i>Other long-term liabilities not elsewhere classified.</i>
OTHER LIABILITIES <i>The totality of all other liabilities that cannot be classified under any of the preceding liability accounts.</i>		
331	Deposits for Share Capital Subscription	<i>Amount paid by the members for future subscription of additional share capital when the authorized capital has been fully subscribed and paid pending amendment of the Cooperative's Articles of Cooperation and By-laws.</i>
332	Project Subsidy Fund Payable	<i>Unused portion of the donation/grant for training, salaries and wages, etc.</i>

Account Title		Brief Definition/Description
333	Mutual Benefit Funds Payable	<i>Funds for special purposes such as member's welfare and benefits, i.e., loan protection, hospitalization, death aid, etc., including KBGF/CGF not taken from net surplus.</i>
334	Due to Head Office /Branch/Subsidiary	<i>Liabilities to head office/branch or subsidiary.</i>
EQUITY ACCOUNTS <i>Excess of a cooperative's assets over its liabilities.</i>		
MEMBERS' EQUITY <i>Interest of members in the cooperative.</i>		
361	Subscribed Share Capital – Common	<i>The amount of share capital subscribed by regular members payable over a certain period of time.</i>
362	Subscription Receivable – Common	<i>The total unpaid subscribed share capital of regular members.</i>
363	Paid-up Share Capital – Common	<i>Subscribed share capital paid by the regular member to the cooperative that is not withdrawn during the term of his/her membership in the cooperative.</i>
364	Treasury Share Capital – Common	<i>Common shares bought back by the cooperative. This account should only be used in the event that there are no members who are willing to buy the shares of outgoing members.</i>
365	Subscribed Share Capital – Preferred	<i>The amount of share capital subscribed by members (regular and associate), payable over a certain period of time.</i>
366	Subscription Receivable – Preferred	<i>The total unpaid subscribed share capital of members (regular and associate).</i>
367	Paid-up Share Capital – Preferred	<i>Preferred share capital subscribed and paid by the members (regular and associate).</i>
368	Undivided Net Surplus (Loss)	<i>The accumulated net surplus of the cooperative that will be allocated and distributed at the end of each accounting period in accordance with Articles 86 and 87 of RA 6938.</i>
DONATIONS / GRANTS		
381	Donations and Grants	<i>Amounts received by the cooperative as awards, subsidies, grants, aids, awards, etc. This shall not be available for distribution as interest on share capital and patronage refund.</i>
STATUTORY FUNDS <i>Mandatory funds established/set up in accordance with Articles 86 and 87 of the cooperative code.</i>		
391	Reserve Fund	<i>Amount set aside annually for the stability of the cooperative (equivalent to at least 10% of net surplus). A corresponding fund should be set up either in the form of time deposit with</i>

Account Title		Brief Definition/Description
		<i>local banks or government securities. Only the amount in excess of the share capital may be used for the expansion and authorized investment of the cooperative as provided for in its by-laws.</i>
392	Education and Training Fund (local)	<i>The amount retained by the cooperative out of the mandatory allocation as stipulated in the cooperative's by laws.</i>
393	Optional Fund	<i>Fund set aside from the net surplus (should not exceed 10%) for future use such as land and building, community developments, etc.</i>
STATEMENT OF OPERATION		
REVENUES <i>Gross increases in assets or gross decreases in liabilities recognized and measured in conformity with generally accepted accounting principles that result from those types of earning activities of a cooperative that can change owners' equity.</i>		
401	Interest Income from Loans	<i>Income earned and collected by the cooperative from the interest charged on the loans granted to their members.</i>
405	Service Fees	<i>Fees collected by the cooperative for loan processing/servicing/collecting.</i>
406	Filing Fees	<i>Fees collected by the cooperative upon the filing of loan applications by the member-borrowers.</i>
407	Fines, Penalties, Surcharges	<i>Fees imposed and collected by the cooperative on the delayed amortization payments of the member-borrower.</i>
408	Membership Fees	<i>Amount collected from the cooperative's member-applicants upon approval of their membership in the cooperative.</i>
409	Income/Interest from Investment	<i>Income earned by the cooperative from bank deposits and investments made in financial institutions/government/business organizations. This shall include interest income derived from the deposit of statutory funds in the bank until utilized. Interest on these funds shall not be used to increase the fund.</i>
410	Miscellaneous Income	<i>All other income earned by the cooperative for which no specific account has been set-up.</i>
EXPENSES <i>Gross decreases in assets or gross increases in liabilities recognized and measured in conformity with generally accepted accounting principles that result from those types of earning-directed activities of a cooperative than can change members' equity.</i>		
FINANCING COSTS		
501	Interest Expense on Deposits	<i>Interest incurred on savings and time deposits of both regular and associate members.</i>

Account Title		Brief Definition/Description
502	Interest Expense on Borrowings	<i>Interest incurred on borrowings.</i>
503	Other Charges on Borrowings	<i>Service charges, filing fees and other fees for borrowings incurred by the cooperative.</i>
ADMINISTRATIVE COSTS		
516	Salaries and Wages	<i>Amount incurred for services rendered by employees including overtime pay.</i>
517	Employees' Benefits	<i>Benefits given to employees other than salaries and wages.</i>
518	SSS/ECC/PhilHealth, Pag-ibig Contributions	<i>The cooperative's share in the employees' contribution to SSS, ECC, PhilHealth, Pag-ibig.</i>
519	Retirement Benefit Expense	<i>The cost of providing retirement benefits to employees for their services rendered. The cost of retirement benefits is recognized as an expense in the periods during which the services are rendered.</i>
538	Officers' Honorarium and Allowances	<i>Amount incurred for services rendered by directors, committee members, and officers.</i>
539	Trainings and Seminars	<i>Amount incurred for officers, directors, members and employees, for attending trainings and seminars including all expenses related thereto after exhausting the CETF (local). For purposes of analysis, amount incurred may be classified as to the recipients of the trainings and seminars.</i>
540	Office Supplies	<i>Expenses incurred for stationery and various supplies used for operation.</i>
551	Power, Light and Water	<i>Cost of electricity, water, gasoline, diesel, oil and lubricants incurred in business operations.</i>
552	Travel and Transportation	<i>Amount incurred for fares, gasoline and fuel for service vehicles, toll fees, board and lodging, per diem and meal allowances of officers and employees and members while on official travel.</i>
553	Insurance	<i>Expenses incurred to insure the assets/properties of the cooperative and the bonds of accountable officers and employees.</i>
554	Repairs and Maintenance	<i>Expenses incurred in the repair and maintenance of each facility and equipment except major repairs that prolong the life of the asset.</i>
555	Rental	<i>Expenses incurred for building/office spaces or facilities leased by the cooperative.</i>
556	Taxes and Licenses	<i>Expenses incurred for taxes and fees due to government entities, both national and local.</i>

Account Title		Brief Definition/Description
557	Professional Fees	<i>Fees and related expenses incurred for professional services rendered.</i>
558	Communication Expense	<i>Amount incurred for courier (letters), telephone, e-mail, fax, internet, messengerial, and all other means of communication.</i>
559	Representation	<i>Expenses incurred related to accommodating visitors and guests on official business.</i>
560	General Assembly Expenses	<i>Expenses incurred in the conduct of general assembly meeting whether regular or special.</i>
561	Meetings and Conferences	<i>Expenses incurred for meetings and conferences of directors, committee members, officers and staff.</i>
562	Bank Charges	<i>Bank fees and other charges.</i>
563	Collection Expense	<i>Amounts, including commissions, incurred as incentives in effecting the collection of loans of the cooperative.</i>
564	Litigation Expenses	<i>Expenses incurred in legal cases.</i>
565	Affiliation Fees	<i>Amount incurred to cover membership or registration fees and annual dues to a federation or union.</i>
566	Social Services Expenses	<i>Expenses incurred by the cooperative in its social community involvement including provision for KBGF/CGF</i>
567	Promotional Expenses	<i>Expenses incurred for advertising and promotions.</i>
568	Periodicals, Magazines, Subscriptions	<i>Expenses incurred for periodicals, magazines and other publications.</i>
569	General Support Services guards, janitors and messengers.	<i>Expenses incurred for employing the services of security</i>
570	Members' Benefit Expenses	<i>All expenses incurred for the benefit of the members.</i>
575	Miscellaneous Expense	<i>All other expenses incurred by the cooperative not classified under any of the specified expense accounts.</i>
576	Depreciation and Amortization	<i>Amount provided for wear and tear of property and equipment and amortization of intangible assets.</i>
577	Amortization of Leasehold Rights and Improvements	<i>Amount provided for amortization of leasehold rights and improvements.</i>
578	Provision for Probable Losses on Loans	<i>Allocation or provision for estimated losses arising from probable uncollectible accounts/loans.</i>
EXTRAORDINARY ITEMS		
590	Project Subsidy	<i>This shall appear at the statement of operation as a contra account to Subsidized Project Expenses.</i>

	Account Title	Brief Definition/Description
591	Subsidized Project Expense	<i>Portion of the Project Subsidy Fund expended for training, salaries and wages and other activities subsidized by donations and grants.</i>
592	Gain or Loss on Sale of Acquired Assets/Properties and Equipment	<i>Gain or loss derived from the sale of acquired assets/properties and equipment.</i>
593	Gain or Loss on Investment	<i>Income earned or loss incurred from the disposal or permanent decline of value of investments.</i>

V. Pro-forma Financial Reports with supporting schedules

For purposes of monitoring, supervising and regulating credit cooperatives and other types of cooperatives with credit services, the basic financial reports include the following:

- a. Statement of Financial Condition
- b. Statement of Operation
- c. Statement of Cash Flows
- d. Related schedules such as:
 - Bank reconciliation
 - Aging of loans receivables
 - Property and equipment
 - Members' loans receivables, savings/time deposits, subscribed and paid-up share capital
 - Investments
 - Accounts payable
 - Loans payable
 - Uses of:
 - a) Reserve fund
 - b) Optional fund
 - c) Education and training fund
 - Apex
 - Local

A. STATEMENT OF FINANCIAL CONDITION

Name of Cooperative
 Address of Cooperative
 Registration/Confirmation No.
 Statement of Financial Condition
 As of _____

	Current Year	Prior Year
ASSETS		
Current Assets		
Cash on Hand		
Cash in Bank		
Petty Cash Fund		
Revolving Fund		
Cash Advances to Officers & Employees		
Short Term Investment		
Loans Receivable		
Current		
Restructured		
Past Due		
In Litigation		
Total Loans Receivables		
Less: Allowance for Probable Losses on Loans		
Receivables from Accountable Officers & Employees		
Other Receivables		
Unused Office Supplies		
Prepaid Expenses		
<i>Total Current Assets</i>		
Long-Term Investments		
Cooperatives		
Government Securities/Bonds		
Others		
<i>Total Long-Term Investments</i>		
Property & Equipment		
Land		
Land Improvements		
Less: Accumulated Depreciation – Land Improvements		
Building		
Less: Accumulated Depreciation – Building		
Furniture, Fixtures & Office Equipment		
Less: Accumulated Depreciation – FF & OE		
Transportation Equipment		
Less: Accumulated Depreciation – Trans. Equipment		
Leasehold Rights and Improvements		
<i>Total Property & Equipment</i>		
Other Assets		
Organizational Costs		

	Current Year	Prior Year
Computerization Costs		
Other Funds and Deposits		
Due from Head Office/Branch Subsidiary		
Assets Acquired in Settlement of Loans		
Other Land		
Other Building		
Less: Accumulated Depreciation – Other Building		
Miscellaneous Assets		
<i>Total Other Assets</i>		
TOTAL ASSETS		
LIABILITIES		
Current Liabilities		
Savings Deposits		
Time Deposits		
Loans Payable – Short Term		
SSS/ECC/Phil health Premium & Pag-ibig		
Contributions Payable		
Withholding Tax Payable		
Accrued Expenses		
Interest on Share Capital Payable		
Patronage Refund Payable		
Due to CETF (Apex)		
Unearned Income		
Other Payables		
<i>Total Current Liabilities</i>		
Long-Term Liabilities		
Loans Payable – Long Term		
Revolving Capital Payable		
Retirement Fund Payable		
Other Long –Term Payables		
<i>Total Long-Term Liabilities</i>		
Other Liabilities		
Deposits for Share Capital Subscription		
Project Subsidy Fund Payable		
Mutual Benefit Funds Payable		
Due to Head Office/Branch/Subsidiary		
<i>Total Other Liabilities</i>		
TOTAL LIABILITIES		

	Current Year	Prior Year
EQUITY		
Members' Equity		
Common Share Capital – Authorized Share		
Capital _____ Shares @ P_____ par value		
Subscribed Share Capital – Common		
Less: Subscription Receivable – Common		
Paid-Up Share Capital – Common		
Treasury Shares (Common)		
Preferred Shares Capital – Authorized Share		
Capital _____ Shares @ P_____ par value		
Subscribed Share Capital – Preferred		
Less: Subscription Receivable – Preferred		
Paid-Up Share Capital – Preferred		
<i>Total Paid-Up Share Capital</i>		
*Undivided Net Surplus		
<i>Total Members' Equity</i>		
Donations/Grants		
Donations and Grants		
Statutory Funds		
Reserve Fund		
Education & Training Fund (Local)		
Optional Fund		
<i>Total Statutory Funds</i>		
TOTAL LIABILITIES AND EQUITY		

* To be used only for interim statement of financial condition

B. STATEMENT OF OPERATION

Name of Cooperative _____
 Address of Cooperative _____
 Registration/Confirmation No. _____
 Statements of Operation _____
 For the Years Ended _____

	Current Year	Prior Year
REVENUE		
Interest Income from Loans		
Service Fees		
Filing Fees		
Fines, Penalties, Surcharges		
Membership Fees		
Income/Interest from Investment		
Miscellaneous Income		
<i>Total Revenue</i>		
EXPENSES		
Financing Costs		
Interest Expense on Deposits		
Interest Expense on Borrowings		
Other Charges on Borrowings		
<i>Total Financing Costs</i>		
Administrative Costs		
Salaries and Wages		
Employees' Benefits		
SSS, ECC, PhilHealth, Pag-Ibig Contributions		
Retirement Benefit Expense		
Officers' Honorarium & Allowances		
Training/Seminars		
Office Supplies		
Power, Light and Water		
Travel and Transportation		
Insurance		
Repairs and Maintenance		
Rental		
Taxes and Licenses		
Professional Fees		
Communication Expense		
Representation		
General Assembly Meeting Expenses		

	Current Year	Prior Year
Meetings and Conferences		
Bank Charges		
Collection Expenses		
Litigation Expenses		
Affiliation Fees		
Social Services Expenses		
Promotional Expenses		
Periodicals, Magazines, Subscriptions		
General Support Services		
Members' Benefit Expenses		
Miscellaneous Expenses		
Depreciation and Amortization		
Amortization of Leasehold Rights & Improvements		
Provision for Probable Losses on Loans		
<i>Total Administrative Costs</i>		
Total Expenses before Subsidized Project Expenses		
Add: Subsidized Project Expenses		
TOTAL EXPENSES		
Net Surplus before Project Subsidy		
Add: Project Subsidy		
Net Surplus on Operations		
Add/(Deduct) Extraordinary Items		
Gain or Loss on Sale of Acquired Assets/ Property & Equipment		
Gain or Loss on Investment		
NET SURPLUS (FOR ALLOCATION)		
Reserve Fund – Minimum of 10% of Net Surplus (NS)		
Coop Education & Training Fund – Maximum of 10% of NS		
Optional Fund – Maximum of 10% of NS		
Amount Available for Interest on Share Capital and Patronage Refund		
NET SURPLUS (AS ALLOCATED)		

C. STATEMENT CASH FLOWS

Name of Cooperative _____
 Address of Cooperative _____
 Registration/Confirmation No. _____
 Statement of Cash Flows
 For the Years Ended _____ and _____

	Current Year	Prior Year
Cash Flows from Operating Activities		
Net Surplus		
Adjustments to reconcile net surplus to net cash provided by operating activities		
Add: Depreciation and amortization		
Provision for probable losses on loans		
Amortization of leasehold rights & improvements		
Increase in other liabilities		
Increase in operating assets & liabilities		
Less: Gain on sale of acquired assets/properties and equipment		
Undistributed income/interest from investment		
Total Adjustments		
Net cash provided by operating activities		
Cash flows from investing activities		
Proceeds from sale of acquired assets/properties and equipment		
Income/Interest on investments		
Gain on sale of investments		
Less: Capital expenditures		
Net cash used in investing activities		
Cash flows from financing activities		
Net borrowings under line-of-credit agreement		
Less: Principal payments		
Proceeds from issuance of long-term agreement		
Proceeds from issuance of share capital		
Less: Interest on share capital & patronage refund paid		
Net cash provided by financing activities		
Net Increase in Cash and Cash Equivalents		
Cash and Cash Equivalent at beginning of year		
Cash and Cash equivalent at end of year		

I. Sanctions

Credit and other types of cooperatives with credit services, which fail to comply with this Circular, shall be subject to the following sanctions:

- a. First non-compliance, the Authority shall issue warning to concerned cooperatives;
- b. Second non-compliance, certificate of good standing shall not be issued by the Authority;
- c. Third non-compliance, cooperative shall be cancelled after compliance with due process of law.

II. Transitory Provision

All credit and other types of cooperatives with credit services shall within one (1) year from the effectivity of this Circular install necessary adjustments on their existing systems in order to comply with it. Provided however, that the aforementioned sanctions under item VI hereof shall not be imposed during the transition period.

III. Repeals

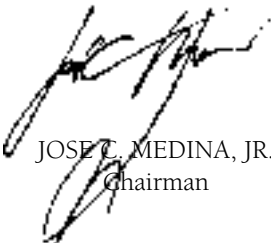
All circulars, regulations, issuances or parts thereof, inconsistent with any of the provisions of this Circular are hereby repealed or modified accordingly.

IV. Separability Clause

Should any part of this Circular be declared invalid or unconstitutional, the rest of the provisions not affected thereby shall continue in full force and effect.

V. Effectivity

This Circular shall be published in two newspapers of general circulation or official gazette and shall take effect on the first day of January, 2003.



JOSE C. MEDINA, JR.
Chairman



Republic of the Philippines
OFFICE OF THE PRESIDENT
COOPERATIVE DEVELOPMENT AUTHORITY
5th and 6th Flr. BLENDED Bldg. 1884 Quezon Avenue, Quezon City

MEMORANDUM CIRCULAR NO. 2003-04

Series of 2003

30 June 2003

**TO : ALL CDA DEPARTMENT AND REGIONAL DIRECTORS,
REGISTERED / CONFIRMED CREDIT AND OTHER TYPES
OF COOPERATIVES WITH CREDIT SERVICES AND ALL
CONCERNED**

**SUBJECT : PERFORMANCE STANDARDS FOR CREDIT AND OTHER
TYPES OF COOPERATIVES WITH CREDIT SERVICES
(COOP-PESOS)**

Pursuant to Section 3 of Republic Act No. 6939, an Act Creating the Cooperative Development Authority defining its Powers, Functions and Responsibilities, the Authority hereby issues this Memorandum Circular prescribing the use of Performance Standards or COOP-PESOS, after a series of workshops, consultations and validations with the cooperative sector and concerned institutions / agencies.

I. SCOPE

All credit and other types of cooperatives with credit services adopting and implementing the Standard Chart of Accounts in compliance with Memorandum Circular No. 02-04, series of 2002 are hereby required to use the COOP-PESOS in the assessment/evaluation of their performance to ensure the protection of members, cooperatives and the sustainability of the latter's operations.

II. DEFINITION OF TERMS

PERFORMANCE STANDARDS OR COOP PESOS - are set of indicators that will measure the performance of a credit cooperative's operations in terms of compliance to administrative requirements, management and financial performance.

PORTFOLIO AT RISK - failure to receive payment one day after due date of amortization make the entire loan balance at risk.

ALLOWANCE FOR PROBABLE LOSSES ON LOANS - allowance is provided for the unpaid entire loan balance based on PAR with a grace period of 1-30 days.

LOANS RESTRUCTURED- are past due loans whose term have been extended or renewed after full payment of interest charges due thereon. Loans restructured will be considered performing or current when there is a good tracking record of continuous payment of the amount agreed upon using the following installments: 3 installment for monthly; 4 installments for semi-monthly; 6 installments for weekly and 10 installments for daily. It will be considered past due when it is not performing, i.e., there are no payments received after restructuring.

LIQUID ASSETS – include Cash, Cash in Bank, Investment in Marketable Securities (those easily convertible to cash within 30 days except deposits)

PROBLEM ASSETS – are investments in closed banks, cooperatives and other institutions.

NON EARNING ASSETS – are assets that do not give direct revenues to the cooperative, I, e., Cash on Hand, Non – interest bearing checking accounts, Accounts Receivable, Assets in Liquidation, Fixed Assets (Land, Building, Equipment, etc.), Prepaid Expenses and other deferrals, and problem assets.

AVERAGE MEMBER'S SHARE– beginning members' share capital + ending members' share capital divided by two.

AVERAGE TOTAL LOANS OUTSTANDING – beginning total loans outstanding + ending total loans outstanding divided by two.

AVERAGE TOTAL ASSETS – beginning total assets + ending total assets divided by two.

III. OBJECTIVES /PURPOSES

1. *SUPERVISORY AND REGULATORY TOOL*. - since fund of the credit cooperatives are mainly coming from its members, the safety and soundness of the credit cooperative's operation is important. It is important to ensure that the member's money in the credit cooperative is safe considering that the credit cooperative's fiscal funds come from members who are small and who belong to the low income segment of the community. This calls for an effective body which will supervise and regulate the credit cooperatives. The Philippine performance indicators and standards that were established will be used by the Authority to make sure that the credit cooperatives will have the necessary operational and financial discipline that ensures the safety and soundness of their operations. Ensuring the safety and soundness of the credit cooperative will result in greater public confidence, hence providing growth to the sector.

CDA will use these standards to evaluate the performance of credit cooperatives. Results of the evaluation and assessment of the credit cooperative's performance against certain standards will allow CDA and the designated supervisor/regulator to compare the performance of various cooperatives over time and across peers.

2. *MANAGEMENT TOOL*. - The adoption of the Philippine Performance Standards or COOP PESOS will provide management the necessary information on how its cooperative is performing vis-à-vis other credit cooperatives. Management shall use the standards in making sure that the cooperative is operating effectively and efficiently. Comparing a credit cooperative's performance against specific standards will allow the management of the cooperative to determine troubled areas and make the necessary adjustments to its policies and/or the way the cooperative's operations are handled.

The performance standards for credit cooperatives in the Philippines were developed for both of these purposes. The performance ratios and standards that were identified are those that will be used both by CDA and its designated supervisors and internally by management.

IV. PERFORMANCE STANDARDS FOR PHILIPPINE CREDIT COOPERATIVES AND OTHER TYPES OF COOPERATIVES WITH CREDIT SERVICES (COOP – PESOS)

The Performance Standards for Philippine Credit Cooperatives and Other Types of Cooperatives with Credit Services has two key components 1) indicators on compliance to administrative requirements and 2) indicators on financial performance.

IV.1 INDICATORS ON COMPLIANCE TO ADMINISTRATIVE REQUIREMENTS AND MANAGEMENT (COOP)

These indicators comprise a set of questions, which would give information on the cooperative's compliance with the necessary administrative requirements. The questions also provide information on the governance, management, and organizational structure of the coop. These indicators also look at whether the credit cooperatives has adequate system, policies and procedures to ensure efficient operations and effective service to members. The indicators under this component are grouped into the following and are given the acronym **COOP**.

C *Compliance with Administrative and Legal requirements*

This includes questions which look on whether the credit cooperative complies with the various legal requirements imposed by various institutions (e.g. Cooperative Development Authority, Bureau of Internal Revenue, Local Government Unit and the Department of Labor and Employment, etc.).

O *Organizational Structure and Linkages*

This includes questions on the cooperative's governance and membership structure. It also includes questions on affiliation and linkages with cooperative federations / unions and other organizations involved in the promotion and development of cooperatives.

O *Operation and Management*

This includes indicators that determine presence or absence of the necessary system, policies and procedures for efficient and effective management of credit cooperative. Questions related to the Board of Directors and the cooperative's management are included in this portion.

P *Plans and Programs*

This includes parameters to determine whether the credit cooperative has a development plan and an approved plan and annual budget. This also looks at whether the credit cooperative reviews its performance vis-à-vis the projections in the business plan of the credit cooperative.

IV.2 INDICATORS ON FINANCIAL PERFORMANCE (PESOS)

This component is comprised of indicators that look at the financial performance of the credit cooperative. It has the following major categories:

Portfolio Quality

The first group of ratios/indicators provides the manager and the board of directors of credit cooperatives appropriate tools in monitoring the quality of the portfolio of the cooperatives. This should be monitored closely inasmuch as the loan portfolio accounts constitute the bulk of the credit cooperative's assets. In view of this, it is also important that its assets are adequately protected. Protection is measured by comparing the adequacy of the provisions for loan losses against the amount of delinquent loans. The status of the health of the portfolio of the cooperative will either propel the cooperative to grow more or imperil the whole sustainability program of the cooperative. Two indicators are included in this group. These are:

- Portfolio at Risk
- Allowance for Probable Losses on Loans

Efficiency

The second group of indicators focuses on the operation and administrative efficiency of the delivery of financial services, i. e., loans and savings products to its members. Indicators under this category determine the ability of the credit cooperative to generate sufficient income to cover expenses on operations. This affects the loan profitability of the credit cooperative's portfolio and the return on members' shares. Six (6) ratios are included in this group.

- Asset Yield
- Operational Self-Sufficiency
- Rate of Return on Members' Share
- Loan Portfolio Profitability
- Cost Per Peso Loan
- Administrative Efficiency



Stability

The stability of the credit cooperative is important to ensure that financial services are delivered to its members in a sustained manner. One way to do this is to increase the institutional capital of the cooperative instead of purely relying on the share capital of members. It is also important for the credit cooperative to maintain sufficient liquidity to meet the financial needs of its members. Stability is important since as the cooperative leadership commit itself to ascertain the sustainability in the cooperative structure, the membership of the cooperative will also be serious in strongly supporting their own cooperatives. Listed below are three (3) ratios/indicators under this category:

- Solvency
- Liquidity
- Net Institutional Capital

Operations

Under this group, two (2) indicators are included. These indicators highlight the new thrust for Philippine Credit Cooperatives. The indicators and standards in this group calls for the implementation of a new thrust in the operations of credit cooperative, including decreasing dependence on external borrowings and greater emphasis on mobilizing voluntary savings from members. Strong emphasis is given on mobilizing voluntary savings from its members since it is considered more accessible for members and therefore is more beneficial. Also, emphasis on savings mobilization will result in the credit cooperative's less dependence on external borrowings and lower financial costs. The indicators are:

- Performance on Membership Growth
- Trend in External Borrowings

Structure of Assets

Under this group, four (4) ratios help ascertain the quality and the structure of the assets of the cooperative. The indicators and standards set under this group determine the extent of the share of the cooperative's various assets to its total assets and assess the effective use of these assets to operate revenues. The following four (4) indicators are listed here:

- Non Earning Assets/Total assets
- Total Deposits/Total assets
- Net Loans Receivable/Total assets
- Total Members' Share Capital/total Assets



ANNEX 1 presents the formula and standards for each of these indicators.

The performance standards set for Philippine Credit Cooperatives adopted internationally accepted standards using best practices adopted by credit cooperatives around the world. Using financial statements that adopt the standard chart of account for credit cooperatives and other types of cooperatives with credit services, the PESOS indicators will be computed. The equivalent raw score for both the COOP and PESOS indicators are given the appropriate rating. The overall rating will be computed using a 20 percent weight for the COOP rating and 80 percent weight for the PESOS rating. A sample rating sheet is shown in ANNEX 2. The evaluator will use the sample rating sheet in assessing the performance of the credit cooperative.

IV.3 OVER ALL RATING SYSTEM

The raw score for each of the component is given an equivalent rating. The resulting rating for each of the component is given the appropriate weight to arrive at the overall rating. The following rating scale is used:

- **Rating 1 (96 to 100) – *VERY GOOD***

The credit cooperative has strong performance that consistently provides safe and sound operations. Credit cooperatives in this group comply with cooperative rules and regulations and are resistant to external shocks and financial disturbances. They are also able to withstand unexpected adverse changes in business environment. These institutions do not need supervisory concern.

- **Rating 2 (90 to 95) - *GOOD***

The credit cooperative shows satisfactory performance that consistently provides safe and sound operations. Credit cooperatives in this group are able to withstand business fluctuations well. However, there are some areas of concern that require important attention and if unchecked, can potentially develop into conditions of greater concern. Supervisory response is limited to minor adjustments to ensure that operations continue to be satisfactory and sustainable.

- **Rating 3 (80 to 89) - *FAIR***

The credit cooperative's performance is flawed to some degree and is of supervisory concern. Results of key performance measures indicate that safe and sound operations may be adversely affected. Credit cooperatives in this group are only nominally resistant to adverse business conditions and may deteriorate if identifiable areas of weakness are not corrected immediately.

- **Rating 4 (70 to 79) - *POOR***

The credit cooperative has poor performance and is of serious supervisory concern. The credit cooperative's performance if left unchecked would lead to

conditions that could threaten its viability. A high potential for failure is present but is not yet imminent. Credit cooperatives in this group require very close supervisory attention.

- **Rating 5 (below 70) - *VERY POOR***

The credit cooperative has unsatisfactory performance and is in need of immediate remedial attention. Credit cooperatives in this group have a very high probability of failure and will likely require liquidation.

A handwritten mark, possibly a signature or initials, consisting of a large, sweeping loop that starts near the top left and extends downwards and to the right.

ANNEX I

I. Administrative Compliance and Management Structure (COOP Indicators)

	Maximum Raw Score ¹
<i>Compliance With (20%)</i>	
1. Cooperative Development Authority	9
a. Updated Bond of Accountable Officers	1
b. Registration of Amendments, if any	1
c. Allocation of Net Surplus	1
d. Issuance of Share Capital Certificates	1
e. Submission of Annual Report, Audited Financial Statements and Information Sheet within the prescribed period	5
2. Bureau of Internal Revenue (BIR)	5
a. Registration as Non-EVAT	1
b. Filing of Account Information	1
c. Withholding of Appropriate Taxes (includes taxes on honorarium)	1
d. Certificate of Tax Exemption ²	1
e. Registration of Books of Accounts	1
3. Local Government Unit (LGU)	1
a. Business Permit/License	1
4. Department of Labor and Employment (DOLE)	5
a. Minimum Wage & 13 th Month Pay	1
b. SSS	1
c. Philhealth	1
d. HDMF (Pag-ibig)	1
e. Retirement Benefits	1

¹ The credit and other types of cooperative get the maximum raw score for every positive answer and zero for every negative answer.

² Excludes cooperatives who are no longer eligible and those applications are still in process.

	Maximum Raw Score ¹
Organization (26%)	
1. Governance and Membership Participation	15
a. Gender Integration (availability of sex-disaggregated data on officers and staff, loan borrowers, depositors)	1
b. Attendance of the majority of members in:	
– Annual General Assembly (GA)	2
– Membership Education/Consultation	2
c. Capital Build-up and Savings Mobilization	
– 70% of members (regular and associate) regularly contribute to share capital	2
– at least 70% of the total members are depositors	2
d. Acceptance of Audited Financial Statements by the GA	2
e. Approval of Development Plan by the General Assembly	2
f. Adoption of proper procedures for the election of the Board of Directors	2
2. Conduct of regular pre-membership education	2
3. Affiliation/Linkages	9
a. – Laboratory Cooperative ³	1
– Community Services/Involvement	3
b. Participated actively in federation/union activities/programs	1
c. Paid annual due, CETF, loans and other accounts to the federation/union	1
d. Business alliance with	
– Federation	1
– Other Cooperatives	1
e. Submission of Audited Financial Statements using SCA and Annual Report to the federation/union	1
Operation And Management (40%)	
1. Manual of Operational Policies with specific provisions on the following:	24
a. Membership	2

³ Those with laboratory cooperatives may qualify for points under this category.

	Maximum Raw Score ¹
b. Loaning	4
c. Savings/Time Deposits	4
d. Financial Management	
– Asset/Liability	2
– Accounting	3
– Internal Control	4
e. Human Resource Development	
– Hiring, Promotion and Firing	1
– Staff Development	1
– Compensation/Benefits	1
– Performance Appraisal	1
– Job Description	1
2. Board of Directors/Committee	8
a. Board composition in accordance with by-laws	2
b. Meetings of the Directors	1
c. Meetings of the Committees	1
d. Periodic Review of Policies	2
e. Updated Minutes of Meetings	1
f. Updated Committee Reports	1
3. Management	8
a. Full-time qualified manager	3
b. Policy on succession of manager and other top positions	3
c. Personnel File	1
d. Organization Structure	1
<i>Plans/Programs And Performance (14%)</i>	
1. Presence of	7
a. Vision, Mission and Goal	1
b. Developmental Plan	2
c. Approved Annual Plan and Budget	2
d. Code of Ethics	2
2. Performance Review vis-à-vis Projections	7

II. Financial Performance (PESOS Indicators)

Ratios	Formula	Purpose	Standard	Score	Equivalent Points
Portfolio Quality (25%)					
Portfolio at Risk	$\frac{\text{Balance of Loans with one day missed payments}}{\text{Total Loans Outstanding}}$	Measures the risk of default in the portfolio.	5% or less	<ul style="list-style-type: none"> • 5% or less • > 5% to 10% • > 10% to 15% • > 15% to 20% • > 20% to 25% • > 25% 	15 12 9 6 3 0
Allowance for Probable Losses on Loans		Measures the adequacy of the allowance for expected losses on loans.			
• APLL (over 12 months past due)	<p>If total amount of allowance > total outstanding balance of loans over 12 months past due using PAR = 100%</p> <p>If total amount of allowance < total outstanding balance of loans over 12 months past due using PAR then:</p> $\frac{\text{Total Amount of Allowance}}{\text{Total Outstanding balance of loans over 12 months past due using PAR}}$		100%	APLL (100%)⁴ <ul style="list-style-type: none"> • 100% • 80% to < 100% • 60% to < 80% • 35% to < 60% • 10% to < 35% • < 10% 	5 4 3 2 1 0
• APLL (1 to 12 months past due)	$\frac{\text{Total Amount of Allowance - Required Amount of Allowance for loans over 12 months past due using PAR}}{\text{Total Outstanding balance of loans 1 to 12 months past due using PAR}}$		35%	APLL (35%)⁵ <ul style="list-style-type: none"> • 35% • 25% to < 35% • 17% to < 25% • 9% to < 17% • 1% to < 9% • < 1% 	5 4 3 2 1 0
Efficiency (20%)					
Asset Yield	$\frac{\text{Undivided Net Surplus}}{\text{Average Total Assets}}$	Measures the ability of the coop's assets to generate income.	At least inflation rate	<ul style="list-style-type: none"> • At least inflation rate • 1 to 2 percentage points below inflation rate • 3 to 4 percentage points below inflation rate • more than 4 percentage points below inflation rate • 0 or negative asset yield 	4 3 2 1

⁴ Coops without loans over 12 months past due will automatically be given 5 points.

⁵ Coops without loans 1 to 12 months past due will automatically be given 5 points.

Ratios	Formula	Purpose	Standard	Score	Equivalent Points
Operational Self-Sufficiency	Interest Income from Loans + Service Fees + Filing Fees + Fines, Penalties, Surcharges	Measures the ability of the cooperatives to sustain its operations.	> 100%	• 120% and above	4
	Financing Costs + Admin Costs			• 110% to < 120%	3
Rate of Return on Member's Share	Interest on Share Capital	Measures the earning power of member's share capital.	Higher than inflation rate	• 100% to < 110%	2
	Average Member's Share			• 100%	1
				• < 100%	0
				• higher than inflation	4
				• inflation rate	3
Loan Portfolio Profitability	Interest Income from Loans + Service Fees + Filing Fees + Fines, Penalties and Surcharges	Measures how profitable the loan portfolio is.	More than 20%	• 1 to 2 percentage points below inflation rate	2
	Average Total Loans Outstanding			• more than 2 percentage points below inflation rate	1
				• 0 or negative ROR	0
				• 20% and above	4
				• 15% to < 20%	3
Cost per Peso Loan	Financing Costs + (Admin Costs – Members' Benefit Expense)	Measures efficiency in managing the coop's loan portfolio.	PhP 0.10 per PhP1.00 loan	• 10 to < 15%	2
	Average Total Loans Outstanding			• 5% to < 10%	1
				• < 5% or negative surplus ratio	0
				• > 0.10 and 0.15	1.5
				• > 0.15 to 0.20	1
Administrative Efficiency	Administrative Costs	Measures the cost of managing the coop's assets.	3 to 10%	• above 0.20	0
	Average Total Assets			• 10% and below	2
				• > 10% to 15%	1.5
Stability (30%)					
Solvency	(Assets + Allowances) - (Total Liabilities – Deposits + Past Due Loans + Loans Restructured + Loans Under Litigation)	Measures the degree of protection that the coop has for member savings and shares in the event of liquidation of the coop's assets and liabilities.	At least 110%	• 110% and above	10
	Deposits + Share Capital			• 100% to < 110%	8
				• 90% to < 100%	6
				• 80% to < 90%	4
				• 70% to < 80%	2
Liquidity	Liquid Assets - Short Term Payables	Measures the coop's ability to service its member's deposit on time.	Not less than 15%	• below 70%	0
	Total Deposits			• 15% and above	10
				• 12% to < 15%	8
				• 9% to < 12%	6
				• 6% to < 9%	4
Net Institutional Capital	(Reserves + Allowance from Probable Loan Losses) – (Past Due Loans + Loans Under Litigation + Problem Assets)	Measures the level of institutional capital after subtracting the losses.	At least 10%	• 1% to < 6%	2
				• 1% to < 3%	2
				• below 1%	0
				• 3% to < 5%	4
				• 5% to < 7%	6
				• 7% to < 10%	8
	• 10% and above			10	
Total Assets					

Ratios	Formula	Purpose	Standard	Score	Equivalent Points	
Operations (10%)						
Growth in Membership	Actual Increase in the Number of Members	Determines the performance of change in membership vis-à-vis target.	Target set in the development plan	• 75% to < 100% of target	5	
	Target Increase in the Number of Members ⁶			• 50% to < 75% of target	4	
				• 25% to < 50% of target	3	
				• 1% to < 25% of target	2	
				• status quo • decreasing or without development plan	1 0	
Trend in External Borrowings	Ending External Borrowings - Beginning External Borrowings	Determines the percentage of change in external borrowings.	Decreasing towards zero	• no external borrowings	5	
	Beginning External Borrowings			• decreasing compared to previous period	3	
				• status quo • increasing compared to previous period	2 0	
Structure of Assets (15%)						
Asset Quality	Non-earning Assets	Measures the percentage of total assets that are not producing income.	Not more than 5%	• 5% and below	5	
	Total Assets			• > 6% to 8%	4	
				• > 8% to 10%	3	
				• > 10% to 12%	2	
				• > 12 to 14%	1	
• 14% and above	0					
Asset Structure	Total Deposits	Measures the percentage of total assets financed by deposits.	55 to 65%	• > 55% to 65%	5	
	Total Assets			• > 45% to 55%	3	
				• > 65% to 70%		
				• > 35% to 44%	1	
		• > 70% to 75%				
	Net Loans Receivables	Measures the percentage of total assets invested in the loan portfolio.	70 to 80%	• 35% & below	0	
	Total Assets			75% & above		
				• > 70% to 80%	2	
				• > 60% to 70%	1.5	
				• > 80% to 85%		
				• > 50% to 60%	1	
	Total Assets	Measures the percentage of total assets financed by members' share capital.	35 to 45%	• > 85% to 90%		
				• > 40% to 50%	0.5	
				• > 90% to 95%		
				• 40% and below	0	
				95% and above		
	Total Members' Share Capital			• > 35% to 45%	3	
	Total Assets			• > 30% to 35%	2	
				• > 45% to 55%		
				• > 25% to 30%	1	
				above 55% • below 25%	0	

⁶ If target is in growth rate, compute for the nominal amount using the following:

-(Target Growth Rate) Beginning Number of Members = Target Increase in the Number of Members

DEFINITION OF TERMS

Portfolio At Risk (PAR) – refers to the total outstanding balance of loans with one day missed amortization payment. Failure to receive payment one day after due date of amortization, makes the entire loan balance at risk

Allowance for Probable Losses on Loans – This refers to the allowance provided for the unpaid entire loan balance based on PAR with a grace period of 1 - 30 days.

Loans Restructured – are past due loans whose term have been extended or renewed after full payment of interests/surcharges due thereon. Loans restructured will be considered performing or current when there is a good tracking record of continuous payment of the amount agreed upon using the following installments: 3 installments for monthly; 4 installments for semi-monthly; 6 installments for weekly and 10 installments for daily. It will be considered past due when it is not performing, i.e., there are no payments received after restructuring.

Liquid Assets – These are assets easily convertible to cash within 30 days. This includes Cash, Cash in Bank, Investment in Marketable Securities.

Short-Term Payables – These include liabilities payable within 30 days except deposits.

Problem Assets – are investments in closed banks, cooperatives and other institutions.

Non-Earning Assets – are assets that do not give direct revenues to the cooperative, ie. Cash on hand, Non-interest bearing checking accounts, Accounts Receivable, Assets in Liquidation, Fixed Assets (Land, Building, Equipment, etc.), Prepaid Expenses and other deferrals, and problem assets.

Average Members' Share – Beginning Members' Share + Ending Members' Share divided by 2.

Average Total Loans Outstanding – Beginning Total Loans Outstanding + Ending Loans Outstanding divided by 2.

Average Total Assets – Beginning Total Assets + Ending Total Assets divided by 2.

ANNEX 2

<div>Rating Sheet for Philippine Credit Cooperatives</div>				
Name of Cooperative: _____				
Summary				
	Weight	Maximum Raw Score	Actual Score	Rating ^{1/}
COOP	20%			
C		20		
O		26		
O		40		
P		14		
Total COOP Points		100		
PESOS	80%			
P		25		
E		20		
S		30		
O		10		
S		15		
Total PESOS Points		100		
Overall Rating (COOP points x.20 + PESOS points x .80) _____				
1/ Equivalent rating of overall actual raw score:				
1 - 96 to 100				
2 - 90 to 95				
3 - 80 to 89				
4 - 70 to 79				
5 - below 70				

Performance Standards for Philippine Credit Cooperatives (Rating Sheet)

I. Administrative Compliance and Management Structure (COOP Indicators)^{1/}

	Maximum Raw Score ^{1/}	Actual Score	
		Yes	No
Compliance with Administrative and Legal Requirements (20%)			
1. Cooperative Development Authority (CDA)	9		
a. Updated Bond of Accountable Officers	1		
b. Registration of amendments, if any	1		
c. Allocation of Net Surplus	1		
d. Issuance of Share Capital Certificates	1		
e. Submission of Annual Report, audited financial statements and information sheet within the prescribed period	5		
2. Bureau of Internal Revenue (BIR)	5		
a. Registration as non-EVAT	1		
b. Filing of Account Information	1		
c. Withholding of Appropriate Taxes (includes taxes on honorarium)	1		
d. Certificate of Tax Exemption ^{2/}	1		
e. Registration of Books of Accounts	1		
3. Local Government Unit (LGU)	1		
a. Business Permit/License	1		
4. Department of Labor and Employment (DOLE)	5		
a. Minimum Wage & 13th Month Pay	1		
b. SSS	1		
c. Philhealth	1		
d. HDMF (Pag-ibig)	1		
e. Retirement Benefits	1		
Sub-total			
Organization (26%)			
1. Governance and Membership Participation	15		
a. Gender Integration (presence of sex-disaggregated data on officers and staff, loan borrowers, depositors)	1		

^{1/} The credit cooperative gets the maximum raw score for every positive answer and zero points for every negative answer.

^{2/} Excludes cooperatives who are no longer eligible and those whose applications are still in process.

	Maximum Raw Score ^{1/}	Actual Score	
		Yes	No
b. Attendance of the majority of members in:			
– Annual General Assembly	2		
– Membership Education/Consultation	2		
c. Capital Build-up and Savings Mobilization			
– 70% of members (regular & associate) regularly contribute to share capital	2		
– at least 70% of the total members are depositors	2		
d. Acceptance of Audited Financial Statements by the GA	2		
e. Approval of Development Plan by the General Assembly	2		
f. Adoption of Proper Procedures for the election of the Board of Directors	2		
2. Conduct of regular pre-membership education	2		
3. Affiliation/Linkages	9		
a. – Laboratory Cooperative ^{3/}	1		
– Community Services/Involvement	3		
b. Participated actively in federation/union activities/programs	1		
c. Paid annual dues, CETF, loans and other accounts to the federation/union	1		
d. Business alliance with			
– federation	1		
– other cooperatives	1		
e. Submission of audited Financial Statements using SCA and Annual Report to the federation/union	1		
Sub-total			
Operation and Management (40%)			
1. Manual of Operational Policies with specific provisions on the following:	24		
a. Membership	2		
b. Loaning	4		
c. Savings/Time Deposits	4		

^{3/} Those with laboratory cooperatives may qualify for points under this category.

	Maximum Raw Score ^{1/}	Actual Score	
		Yes	No
d. Financial Management	9		
– Asset/Liability	2		
– Accounting	3		
– Internal Control	4		
e. Human Resource Development	5		
– Hiring, Promotion and Firing	1		
– Staff Development	1		
– Compensation/Benefits	1		
– Performance Appraisal	1		
– Job Description	1		
2. Board of Directors/Committees	8		
a. Board composition in accordance with by-laws	2		
b. Meetings of the Directors	1		
c. Meetings of the Committees	1		
d. Periodic Review of Policies	2		
e. Updated Minutes of Meetings	1		
f. Updated Committee Reports	1		
3. Management	8		
a. Full-time qualified manager	3		
b. Policy on succession of manager and other top positions	3		
c. Personnel File	1		
d. Organizational Structure	1		
Sub-total			
Plans/Programs And Performance (14%)			
1. Presence of	7		
a. Vision, Mission and Goal	1		
b. Developmental Plan	2		
c. Approved Annual Plan and Budget	2		
d. Code of Ethics	2		
2. Performance Review vis-à-vis Projections	7		
Sub-total			
TOTAL (COOP Indicators)			

II. Financial Performance (COOP Indicators)

Ratios			Actual Score	Equivalent Points
Portfolio Quality (25%)				
Portfolio at Risk	15	5% or less		
	12	> 5% to 10%		
	9	> 10% to 15%		
	6	> 15% to 20%		
	3	> 20 to 25%		
	0	> 25%		
Allowance for Probable Losses on Loans	APLL (100%)			
	5	100%		
	4	80% to < 100%		
	3	60% to < 80%		
	2	35% to < 60%		
	1	10% to < 35%		
	0	< 10%		
	APLL (35%)			
	5	35%		
	4	25% to < 35%		
	3	17% to < 25%		
	2	9% to < 17%		
	1	1% to < 9%		
	0	< 1%		
Sub-total				
Efficiency (20%)				
Asset Yield	4	at least inflation rate		
	3	1 to 2 percentage points below inflation rate		
	2	3 to 4 percentahr points below inflation rate		
	1	more than 4 percentage points below inflation rate		
	0	0 or negative asset yield		
Operational Self-Sufficiency	4	120% and above		
	3	110% to < 120%		

Ratios			Actual Score	Equivalent Points
	2	100% to < 110%		
	1	100%		
	0	< 100%		
Rate of Return on Members' Share	4	higher than inflation		
	3	inflation rate		
	2	1 to 2 percentage points below inflation rate		
	1	more than 2 percentage points below inflation rate		
	0	0 or negative ROR		
Loan Portfolio Profitability	4	20% and above		
	3	15% to < 20%		
	2	10% to < 15%		
	1	5% to < 10%		
	0	below 5% or negative		
Cost Per Peso Loan	2	0.10 and below		
	1.5	> 0.10 to 0.15		
	1	> 0.15 to 0.20		
	0	above 0.20		
Administrative Efficiency	2	10% and below		
	1.5	> 10% to 15%		
	1	> 15 to 20%		
	0	above 20%		
Sub-total				
Stability (30%)				
Solvency	10	110% and above		
	8	100% to < 110%		
	6	90% to < 100%		
	4	80% to < 90%		
	2	70% to < 80%		
	0	below 70%		

Ratios			Actual Score	Equivalent Points
Liquidity	10	15% and above		
	8	12% to < 15%		
	6	9% to < 12%		
	4	6% to < 9%		
	2	1% to < 6%		
	0	below 1%		
Net Institutional Capital	10	10% and above		
	8	7% to < 10%		
	6	5% to < 7%		
	4	3% to < 5%		
	2	1% to < 3%		
	0	below 1%		
Sub-total				
Operations (10%)				
Performance of Growth in Membership	5	75% to < 100% target		
	4	50% to < 74% of target		
	3	25% to < 50% of target		
	2	1% to < 24% of target		
	1	status quo		
	0	decreasing or without development plan		
Trend in External Borrowings	5	no external borrowings		
	3	decreasing compared to previous period		
	2	status quo		
	0	increasing compared to previous period		
Sub-total				
Structure of Assets (15%)				
Asset Quality	5	5% and below		
	4	> 6% to 8%		

Ratios			Actual Score	Equivalent Points
	3	> 8% to 10%		
	2	> 10% to 12%		
	1	> 12% to 14%		
	0	14% and above		
Asset Structure	AS ₁			
	5	> 55% to 65%		
	3	> 45% to 55%		
		> 65% to 70%		
	1	> 35% to 45%		
		> 70 to 75%		
	0	35% & below		
		75% & above		
	AS ₂			
	2	> 70% to 80%		
	1.5	> 60% to 70%		
		> 80% to 85%		
	1	> 50% to 60%		
		> 85% to 90%		
	0.5	> 40% to 50%		
		> 90% to 95%		
	0	40% and below		
		95% and above		
	AS ₃			
	3	> 35% to 45%		
	2	> 30% to 35%		
	1	> 45 to 55%		
		> 25% to 30%		
	0	above 55%		
		below 25%		
Sub-total				
Total PESOS				

V. ADOPTION AND IMPLEMENTATION

All credit and other types of cooperatives with credit services are enjoined to adopt and implement the Performance Standard for Credit Cooperatives starting calendar year 2003.

It is encouraged that credit cooperatives and other types of cooperatives with credit services shall see to it that ratings to be obtained in the COOP PESOS be in upward trends until they reach RATING 1 or a VERY GOOD RATING.

Toward this end, all CDA Regional Directors are hereby directed to ensure that all credit cooperatives and other types of cooperatives with credit services are using the Performance Standards or COOP PESOS to assess/evaluate their business operations.

VI. FOR INFORMATION AND STRICT COMPLIANCE.



ADM. OMBRE S. HAMSIRANI
Acting Chairman



Regulatory Framework for Microfinance in the Philippines

The government recognizes microfinance as one of the important tools in the current government's fight to alleviate poverty. This is clearly articulated in the President's State of the Nation Address (SONA) in July 2001. The specific policies and strategies to be pursued for the effective delivery of microfinance services are spelled out in the National Strategy for Microfinance (NSM). The government's microfinance policy is built on the following principles:

- *Greater role of private microfinance institutions (MFIs) in the provision of financial services;*
- *An enabling policy environment that will facilitate the increased participation of the private sector in microfinance;*
- *Market-oriented financial and credit policies, e.g. market-oriented interest rates on loan and deposits;*
- *Non-participation of government line agencies in the implementation of credit and guarantee programs.*

Using these policy principles, a framework for the development of the microfinance industry was formulated. This framework provides the government's thrust and policy direction for the microfinance industry and delineates the role and the responsibilities of each of the players¹ in the microfinance industry in both the public and the private sector.

The government's clear policy directions on microfinance resulted in an increased number of private institutions engaged in the provision of micro-finance services. Because of this, appropriate supervision and regulation of microfinance institutions is an important issue that has recently been brought to the fore by both the government and the microfinance practitioners. Appropriate regulation and supervision of microfinance is important to ensure that risks associated with microfinance are minimized and appropriately managed by the concerned MFIs. The continued viability and sustainability of these institutions is important for microfinance to effectively contribute to the poverty alleviation objective.

Recognizing the importance of appropriate regulation in ensuring the delivery of sustainable and efficient microfinance services, the Executive Committee of the National Credit Council (NCC) and the National Anti-Poverty Commission (NAPC) created a technical working group,² which is tasked

¹ *The Framework for Microfinance Development categorizes the following players in the microfinance industry: the clients, microfinance institutions, wholesale lenders, service institutions, and concerned government agencies involved in microfinance policy formulation and regulation. The framework outlines the different activities that will be pursued by the concerned players given the policies and strategies espoused in the National Strategy for Microfinance. This regulatory framework forms part of the Framework for the Development of Microfinance.*

² *The Technical Working Group (TWG) is composed of representatives from the following government agencies: Bangko Sentral ng Pilipinas (BSP), Cooperative Development Authority (CDA), Philippine Deposit Insurance Corporation (PDIC), Peoples Credit and Finance Corporation (PCFC), National Anti-Poverty Commission (NAPC), Land Bank of the Philippines (LBP), Development Bank of the Philippines (DBP), Department of Labor and Employment (DOLE), National Commission on the Role of Filipino Women (NCRFW), Agricultural Credit Policy Council (ACPC). The TWG is also composed of representatives from the private sector i.e. Rural Bankers*

to work on the formulation of an appropriate regulatory framework for microfinance. This paper provides such framework.

I. What is microfinance?

Microfinance is the viable and sustainable provision of a broad range of financial services (savings and credit) generally, by the private sector to poor and low-income households³ engaged in livelihood and microenterprise activities using non-traditional and innovative methodologies and approaches (e.g. non-collateralized cash-flow based lending). The maximum individual loan amount provided for microfinance loans is P150,000.⁴

II. Vision for microfinance

To make microfinance the cornerstone for poverty alleviation, the vision is to have a **viable and sustainable private (micro) financial market**. This will be achieved in a liberalized and market-oriented economy where the private sector plays the major role and the government provides the enabling environment (through the appropriate policy and institutional framework) for the efficient functioning of markets. (National Strategy for Microfinance, 1997). This will be achieved through among other things, the following:

- i. Adoption of market-based financial and credit policies
- ii. Greater private sector participation in the delivery of microfinance services to the basic sector
- iii. Establishment of an appropriate regulatory framework for microfinance

III. Objectives of the Regulatory Framework

- A. To protect the financial system from unsound (i.e. excessively risky) practices by deposit-taking institutions (either from the public or its members) and thereby, protect the country's payments system;
- B. To protect small clients; and
- C. To promote the establishment of an accurate, reliable and transparent set of financial information for all types of MFIs.

Association of the Philippines (RBAP), National Confederation of Cooperatives (NATCCO), and the Microfinance Council of the Philippines (MCP).

³The 1997 NEDA poverty estimates show that the established annual per capita poverty threshold for the Philippines is P11,319. The annual per capita poverty threshold in the urban areas and rural areas is P12,577 and P10,178 respectively. Below this threshold or minimum income, that individual will be considered "poor."

⁴ This definition is consistent with the provisions of RA 8425 (Social Reform Agenda).

IV. *Scope of Microfinance Regulation*

Only institutions taking deposits from the general public and/or from its members are subject to prudential regulation and supervision. Since microfinance NGOs are not supposed to take deposits from their clients, they will not be subjected to prudential regulations. However, those microfinance NGOs that collect savings beyond the compensating balance will be subject to the appropriate regulatory agency.

V. *Definition of Terms*

- A. **Compensating balance** – this refers to the proportion of the total loan of an MFI client, which is retained with the MFI as capital build-up or savings. This amount serves as a hold-out deposit on the loan of the client and can be used by the MFI to off-set the client's outstanding balance in case of default. In view of this, the client is considered a net borrower from the MFI rather than a net saver (i.e. as a borrower of his own savings rather than as a depositor who finance other client's borrowings/loans).*
- B. **Deposit-taking Institutions** – these are financial institutions engaged in the mobilization of savings either from its own members or from the general public.*
- C. **Micro Finance Institutions (MFIs)** –these are institutions engaged in the delivery of microfinancial services (e.g. microsavings and microcredit). Examples of these institutions are rural banks and cooperative banks, thrift banks, credit cooperatives and microfinance NGOs.*
- D. **Microfinance Regulation** – this refers to the issuance of the necessary rules and regulation, including cancellation, suspension and sanctions, governing the intermediation of microfinancial services. The rules and regulations are expected to make sure that all microfinance institutions employing innovative and non-traditional lending methodologies are using sound and prudent practices in their operations.*
- E. **Retail Microfinance Institutions** - these are financial institutions that provide direct micro-financial services to microfinance clients.*
- F. **Regulation** – the act of defining and establishing a set of rules and regulations governing the intermediation of financial resources between savers and borrowers. This also includes the issuance of necessary measures to ensure that financial intermediaries operate in a sound and prudent manner. Rules and regulations are issued to ensure the stability of the payments system.*
- G. **Risk-based Supervision** - this is a supervision approach wherein the supervisor/examiner identifies, classifies and measures the different types of risks faced by the financial institutions in its operations.*
- H. **Supervision** – this refers to the systematic oversight of micro finance institutions to ensure their compliance with the established rules and regulations.*

-
- I. ***Wholesale Microfinance Institutions*** – these are financial institutions, which lend out loanable funds to microfinance institutions.

VI. ***Current Situation of Regulatory Environment***

- A. At present, there are a number of institutions involved in the delivery of micro-financial services to the basic sectors, e.g. the rural banks, thrift banks, credit cooperatives and the micro-finance NGOs. Thrift banks and rural banks are currently being supervised by the Bangko Sentral ng Pilipinas (BSP) while the credit cooperatives are legally under the supervision of the Cooperative Development Authority (CDA). The microfinance NGOs are not being supervised nor regulated by any government regulatory agency.
- B. *Regulatory Environment for Banks*
- B.1. The BSP is the regulatory authority over all banking institutions including those engaged in the provision of micro financial services. BSP issues the necessary rules and regulations for the safe and prudent operations of banks. As part of its regulatory mandate over banks, BSP supervises and conducts regular examination of banks. During examination, examiners check for compliance with banking laws, rules and regulations, soundness of systems for evaluating credit, supervision and collection of loans and the quality of the loan portfolio. While the laws and regulations do not prohibit micro-enterprise lending, most banks are not keen on providing micro-finance loans for fear of being penalized by bank examiners. A study conducted by the Credit Policy Improvement Program (CPIP) reported that lenders subject to BSP supervision guidelines and practices are unclear about the BSP's view on small, clean and unsecured loans that are supported by informal financial information.
- B.2. With the issuance of the National Strategy for Microfinance in 1997, the NCC advocated for the issuance of the necessary measures to implement the policy principles and strategies espoused in the NSM. This led to the inclusion of certain provisions in the General Banking Law that specifically pertains to microfinance.
- B.3. Section 40 of the General Banking Act of 2000 specifically recognized the peculiar characteristics of microfinance and directs the Monetary Board to issue relevant measures specifically to address the apprehension cited by most banks regarding microfinance. Hence, the following circulars were issued by the BSP:
- BSP Circular 272 dated January 30, 2001, which recognizes the peculiar characteristics of microfinance and directs its exemption from rules and regulations issued by the Monetary Board with regards to unsecured loans;
 - BSP Circular No. 273, dated January 30, 2001, which lifts the moratorium on bank branching for those banks engaged in microfinance activities;
 - BSP Circular No. 282 dated 19 April 2001 opens a rediscounting window for microfinance.

C. Regulatory Environment for Credit Cooperatives

- C.1. *The Cooperative Development Authority is mandated under Republic Act 6539 to provide oversight functions for all types of cooperatives. However, despite its legal mandate to regulate and supervise credit coops and other coops with credit services, CDA is not effectively performing this function. CDA has been mostly engaged in development activities⁵, which is also allowed by their present charter. At present, the CDA does not supervise nor examine the books of credit cooperatives.*
- C.2. *In 1997, the National Credit Council through the Credit Policy Improvement Program (CPIP) conducted a review of the regulatory environment for Credit Cooperatives. The review found out that the CDA is not able to effectively implement its regulatory mandate due to conflicting mandates of regulation and development. In view of this, it has mostly been involved in the registration of cooperatives and in the conduct of promotion and development activities for cooperatives. Results of the review also showed that the CDA does not have the necessary basic information for the effective regulation of credit cooperatives (i.e. there is no standard chart of accounts and performance standards for credit cooperatives).*
- C.3. *In 1998, the NCC, in coordination with the CDA, the credit cooperative sector and other government agencies working with the cooperative sector spearheaded work on the establishment of a standard chart of accounts for credit cooperatives and other types of cooperatives with credit services. The CDA has recently issued a circular directing all concerned primary credit cooperatives to adopt and implement the standard chart of accounts.*
- C.4. *The NCC, in coordination with the CDA, the credit cooperative sector and other government agencies, is also currently working on the establishment and adoption of a set of performance standards for credit and other types of cooperatives with credit services.*

D. Regulatory environment for Microfinance NGOs

- D.1. *At present, there is no single agency that has supervision over microfinance NGOs. Microfinance NGOs register with the Securities and Exchange Commission (SEC) as a non-stock, non-profit organization. SEC, however only registers microfinance NGOs. It does not regulate nor supervise them. In view of this, microfinance NGOs do not report to any oversight agency (whether private or public) and hence, there is no single institution that has a complete set of relevant information on the financial performance of microfinance NGOs.*
- D.2. *Almost all microfinance NGOs collect forced savings (sometimes referred to as capital build-up) from their borrower-clients. A number of them argue that the savings they collect from their members are only compensating balances. In view*

⁵ *The Cooperative Code adopts the principle of subsidiarity wherein the cooperative sector will take the lead in the conduct of development activities such as training, promotion and education.*

thereof, there is consensus among microfinance NGOs that they should be allowed to collect savings from their clients without prudential regulation provided that these do not exceed their total loan portfolio. There is concern, however that a number of microfinance NGOs may have collected savings beyond the compensating balance.

D.3. As mentioned earlier, there is no available set of uniform and transparent information that can be used to determine whether the savings collected by the microfinance NGOs are only compensating balances. Since no single agency collects a uniform and transparent set of information among microfinance NGOs. While the Microfinance Council of the Philippines (MCP) is an umbrella organization comprised mostly of microfinance NGOs, not all members submit relevant and uniform set of information to the Council.

D.4. To ensure that microfinance NGOs are operating in a viable and sustainable manner, the Microfinance Council of the Philippines has adopted a set of performance standards for microfinance NGOs. A standard chart of accounts has, likewise, been formulated. Both the performance standards and the standard chart of accounts are however, yet to be widely adopted by the microfinance NGOs.

D.5. The non-adoption of the performance standards and the standard chart of accounts by most microfinance NGOs is attributed to the absence of incentives for adoption.

D.6. The recommended chart of accounts for microfinance NGOs will be reviewed to make this comparable with the chart of accounts of the banks and the credit cooperatives. A technical working group comprised of representatives from both the microfinance practitioners and other stakeholders is currently reviewing the existing set of performance standards for microfinance NGOs. The review is aimed at coming up with a set of standards that are consistent with the performance standards for other types of MFIs (e.g., banks, cooperatives). The NCC will use the results of the review in the formulation of performance standards that cuts across all types of MFIs.

E. Role of Wholesale Financial Institutions

E.1. Generally, loanable funds for microfinance are provided by wholesale lenders that include the following: commercial banks, GFIs and the PCFC, a government-owned and controlled corporation which is specifically tasked to provide wholesale funds for microfinance.

E.2. Current government policy directs the GFIs to provide wholesale funds at market rates to private financial institutions engaged in microfinance.

E.3. Commercial banks also provide wholesale funds to private financial institutions engaged in microfinance using their own funds and adopting their own lending criteria.

VII. *Establishing the Regulatory Framework*

A. *Basic Premises*

A.1. *Should existing regulatory institutions lack the capability to effectively undertake the necessary regulatory functions for microfinance, appropriate measures will be adopted for the establishment of an alternative structure. Otherwise, necessary technical assistance for institutional strengthening will be sought from relevant donor agencies.*

A.1.1 *Only deposit taking institutions will be subjected to regulation.*

A.1.2 *Banks, including GFIs that provide wholesale funds for microfinance, will continue to be regulated by the BSP. General rules and regulations on bank supervision and examination will be applied. Specific rules⁶ to consider the peculiar and unique characteristics of microfinance services will only be applied where applicable, provided these will not unduly affect the stability of the financial system.*

A.1.3. *Credit cooperatives are under the regulatory authority of the CDA.*

A.1.4. *Microfinance NGOs are considered non-deposit taking institutions and therefore, will not be subject to prudential regulation and supervision by any government regulatory authority provided that the total savings collected from their clients should not exceed the total loan portfolio of the microfinance NGO at any point in time.*

- ◆ *Microfinance NGOs that collect savings beyond the compensating balance will be required to transform into a formal financial institution (either a credit coop or a bank) to be able to continue collecting savings from their borrower-clients.*

A.2. *Establishment of a transparent set of information to include sex disaggregated data for microfinance will be promoted among all types of microfinance institutions.*

- ◆ *Since majority of microfinance clients are women, their specific needs should appropriately be considered in the design of microfinance products.*

A.3. *A credit information system containing data on all microfinance loans should also be established by the private sector.*

A.4. *There will be a core set of performance standards for microfinance operations for all types of financial institutions. These standards should be defined and be consistent with international best practices. These standards should likewise be*

⁶ *International best practice shows that risk-based supervision is most applicable for microfinance. In view of this, the supervision and examination process currently used by the BSP is currently being reviewed in the light of its impact on microfinance operations of the banks.*

endorsed and adopted by a rating agency, concerned MFIs and regulatory authorities.

B. Institutional Set-up for Micro-Finance Regulation (see Annex I for the Organigram)

B.1. Bangko Sentral ng Pilipinas

B.1.1. To act as the regulatory and supervisory authority for banks engaged in microfinance operations

B.1.2. To provide the necessary technical assistance to the regulatory unit for credit cooperatives within the CDA responsible for issuing appropriate rules and regulations for credit cooperatives and other cooperatives with credit services. These regulations should be consistent with existing regulations for banks with appropriate adjustments to consider the different structure of the credit cooperatives compared with banks.

B.1.3. To establish a credit information bureau for all loans, including microfinance loans, by all types of banks supervised by BSP.

B.2. Cooperative Development Authority

B.2.1. To act as the regulatory agency for credit cooperatives;

B.2.2 To establish a regulatory and supervisory unit for credit cooperatives responsible for the regulation of credit cooperatives and other types of cooperatives with credit services. This unit will coordinate closely and will be provided technical assistance by the BSP for the issuance of effective rules and regulations.

B.2.3 In the interim that CDA is not yet institutionally ready to directly conduct regulatory activities for credit cooperatives, accredited federations/unions of credit cooperatives and other types of cooperatives with credit services whose membership is voluntary may be authorized to perform quasi self-regulation. The federation/union will supervise and examine the operations of member-coops on a fee-basis using rules and regulations issued by the CDA. The recently approved set of performance standards will be used to rate and brand credit cooperatives and other types of cooperatives with credit services.

B.3 Microfinance Council of the Philippines

B.3.1. The MCP is proposed to serve as the repository of information of microfinance NGOs⁷. Using information submitted by the different

⁷ *The microfinance NGO should issue a certification that it is not collecting savings from its clients beyond the compensatory balance. The MCP may use this certification as basis in monitoring the MFI's compliance with the law not to collect savings from the public.*

MFIs, the MCP will inform concerned regulatory authorities when a microfinance NGO collects savings from members beyond the compensatory balance.

B.3.2. The MCP may collaborate with the SEC and the Philippine Council for NGO Certification on the establishment of incentive mechanisms to enjoin all microfinance institutions (especially the microfinance NGOs) to submit a uniform and consistent set of information regarding their operational and financial performance.

B.3.3. In coordination with concerned agencies and the private sector, the MCP will work toward the establishment of a private risk-rating agency for all financial institutions involved in the delivery of microfinance services. Concerned regulatory authorities for each type of microfinance institutions may use the risk ratings of these institutions in their off-site supervision activities. Donors may also use the ratings in determining the necessary technical assistance appropriate for certain microfinance institutions.

C. Establishment of the necessary infrastructure for financial transparency

C.1. Risk Rating Agency

C.1.1 A private sector risk rating agency will be promoted to provide risk ratings for MFIs that will be used by concerned institutions such as the regulatory authority, donors and wholesale financial institutions (e.g. GFIs and commercial banks) in evaluating the financial performance of the MFIs.

Risk ratings are expected to provide a clear and concise summary of the institutions' risk profile that can be understood by investors who have limited knowledge about the MFI's business operations.

C.1.2 Government should only provide an appropriate policy and institutional environment for private sector to initiate work on the establishment of a risk-rating agency.

C.2. Credit Bureau for microfinance

C.2.1 A Credit Bureau for microfinance shall act as the repository of all credit information regarding microfinance clients;

C.2.2 The credit bureau for bank clients may be established within the BSP. Technical assistance to initiate the establishment of the bureau may be sought from relevant donors.

-
- C.2.3 *A privately initiated credit bureau may also be established to supplement the information from BSP. Information from a privately initiated credit bureau in most cases is more comprehensive than those from the credit bureau within the superintendency of banks. These include credit information of borrowers outside of the banking system (e.g. utilities bill, credit card, other MFI clients etc.).*

D. Minimum set of Parameters for assessing the performance of microfinance institutions

- D.1. **Portfolio Quality**
D.1.1. *Portfolio at risk*
D.1.2. *Past due ratio*
D.1.3. *Provision for loan losses*
- D.2. **Efficiency Indicators**
D.2.1. *Administrative efficiency*
D.2.2. *Operational self-sufficiency*
D.2.3. *Financial self-sufficiency*
- D.3. **Stability Indicators**
D.3.1. *Liquidity*
D.3.2. *Net institutional capital*
- D.4. **Outreach Indicators for microfinance**
D.4.1. *Growth of no. of clients*
D.4.2. *Growth of microfinance loan portfolio*
D.4.3. *Growth of savings*

E. Measures to be undertaken by concerned institutions

E.1. Bangko Sentral ng Pilipinas

- E.1.1. *Review existing regulatory, supervision and examination procedures and guidelines to consider the peculiar characteristics of microfinance. Adopt an appropriate approach for the supervision and examination of banks engaged in microfinance operations (e.g. risk based supervision approach).*
- E.1.2. *Revise, when necessary, relevant rules, regulations and circulars to ensure that regulatory and supervisory guidelines and procedures do not pose as barriers for banks to engage in microfinance operations (e.g. branching guidelines, new banks guidelines, performance indicators, manual of examination etc.)*
- E.1.3. *Provide appropriate technical assistance to the regulatory and supervisory unit of the CDA for credit cooperatives.*

E.2. Cooperative Development Authority

- E.2.1 Establish a regulatory unit for credit cooperatives*
- E.2.2 In coordination with the BSP, formulate and establish relevant regulatory guidelines, policies and procedures for the operations of credit cooperatives.*
- E.2.3 Issue rules and regulations for the effective supervision of credit cooperatives and other types of cooperatives with credit services.*
- E.2.4 Formulate and establish relevant supervision and examination procedures.*

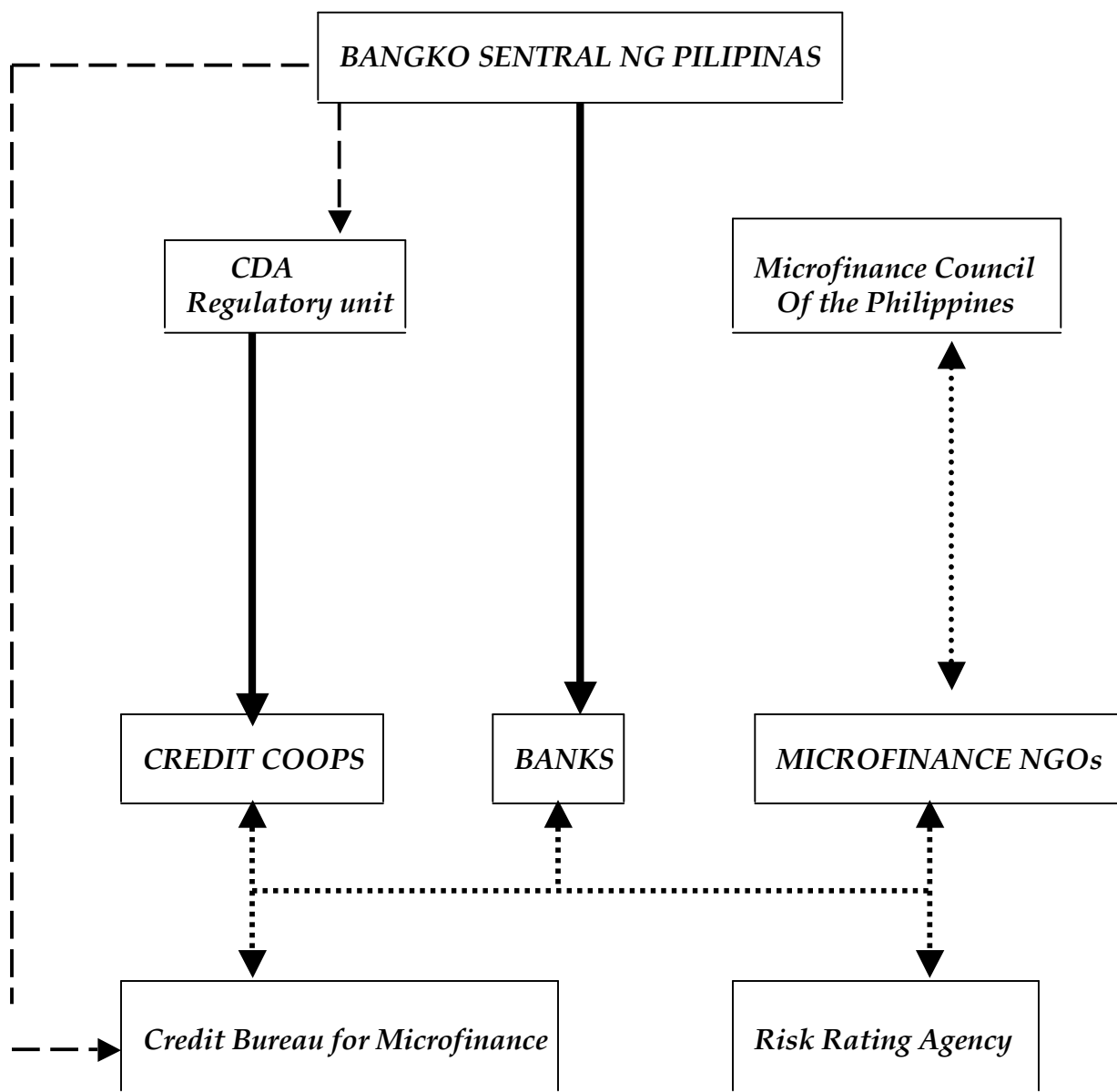
E.3 Microfinance Council of the Philippines

- E.3.1. In coordination with the relevant stakeholders, formulate and establish necessary guidelines and systems for its effective functioning as the repository of information of all MFIs.*
- E.3.2. In coordination with the relevant stakeholders and with appropriate support from relevant government agencies, advocate and work towards the establishment of a credit bureau and risk rating agency for microfinance.*

E.4. National Credit Council

- E.4.1. In consultation with MFIs, relevant private organizations/networks and other concerned government agencies, formulate and establish performance standards for MFIs using the parameters identified in this framework as basis.*
- E.4.2. In consultation with concerned institutions (both public and private), promote and advocate for the establishment of a rating agency and a credit information system.*

ANNEX I
Proposed Institutional Set-up for the Regulation of Microfinance



Legend:

Direct supervision —————

Oversight - - - - -

Submission and assessment of relevant information>

**Performance Standards for All Types of
Microfinance Institutions
in the Philippines**

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Annex 1: Regulatory Framework for Microfinance Institutions (MFIs)

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Performance Standards for All Types of Microfinance Institutions in the Philippines

I. Introduction

The National Credit Council (NCC), an inter-agency body chaired by the Department of Finance (DOF), formulated and approved the **Regulatory Framework for Microfinance Institutions (MFIs) in July 2002 (Annex 1)**. The framework specifically directed the NCC, in coordination with concerned stakeholders, to formulate and develop a uniform set of performance standards that will cut across all types of institutions involved in microfinance. These standards will serve as the microfinance industry benchmarks to allow the comparison of performance among all institutions engaged in the delivery of microfinancial services. These benchmarks will also guide regulators in the assessment of financial institutions under their supervision. It should be noted, however, that these standards are only applicable to financial institutions that are engaged in retail microfinance operations.

The Performance Standards for All Types of Microfinance Institutions are based on international best practices, industry benchmarks and ratios that are being used by different players in the microfinance industry.

II. Purpose of Establishing a Common Set of Standards for Microfinance

As required under the Regulatory Framework for Microfinance Institutions, a common set of performance standards for all institutions engaged in microfinance was formulated and developed by the Technical Working Group (TWG) (**Annex 2**) to allow greater transparency in the operations of MFIs. More particularly, the standards will provide the user the basic tools that will facilitate the evaluation of any type of MFI and compare its financial performance with that of other MFIs, regardless of whether it is a bank, cooperative or an NGO.

The following are expected to use these standards in evaluating the performance of MFIs:

- MFI management;
- Appropriate regulatory authorities;
- Wholesale financial institutions (government and private);
- Donor agencies;
- Domestic and international private sector investors;
- Rating agencies; and
- Social policy institutions.

The indicators and standards can be used in various ways. Management can use these indicators and standards in identifying weak areas in their microfinance operations and in determining the appropriate measures to improve operations. Domestic and international private investors can use

these standards as guideposts in deciding whether they will invest in an MFI or not. Wholesale financial institutions, whether public or private can use these standards in assessing the creditworthiness of MFIs. Donor agencies, on the other hand, can use these standards in identifying the type of assistance for a specific MFI.

III. General Features of Microfinance

- Clients come from the low-income sector, lack assets for collateral, usually self-employed in the informal sector, and are engaged in economic livelihood activities;
- Grant of loans is based on the borrower's household's net cash flow;
- Non-traditional forms of security are acceptable;
- Documentation requirements are simple, loan processing is fast, and loan release is timely;
- Lending methodology may be on a group or individual basis;
- Loan sizes are typically small, not exceeding P150,000; and
- Loans are typically short-term and amortizations are either on a daily, weekly, semi-monthly or monthly basis.

IV. Minimum Criteria in Evaluating Retail Microfinance Institutions

The minimum criteria below will provide a bird's-eye view of the nature and status of the MFI. These institutional criteria indicate whether the financial institution employs sound financial practices and has satisfactory performance and stable financial condition. Moreover, these criteria will indicate the financial institution's capability for and seriousness in microfinance operations.

1. Institutional viability criteria¹

- a. CAMELS rating for banks of at least 3, with management score of not less than 3; and
- b. COOP-PESOS rating for cooperatives with savings and credit services of at least 70 with net institutional capital to total assets ratio of not lower than 5%.

2. Governance

- a. The institution is regularly audited by an independent external auditor. For banks, the auditor should be recognized by the Bangko Sentral ng Pilipinas (BSP); for cooperatives, the external auditor should be accredited by the Cooperative Development Authority (CDA); and for Non-governmental organizations (NGOs), the external auditor should be certified by the Philippine

¹ Use of these criteria is optional for users depending on its purpose.

-
- Institute of Certified Public Accountant (PICPA) as a member in good standing; and
- b. Audited financial statements are readily available.

3. For microfinance operations:

- a. Presence of program objective to reach the poor;
- b. Number of active microfinance clients, classified by gender - at least 500 for group lending or 200 for individual lending;
- c. At least one year in microfinance operations;
- d. Presence of a functioning and effective management information system (MIS) for regular monitoring of microfinance operations as evidenced by timely generation of basic financial, loans tracking, and aging reports using Portfolio at Risk (PAR);
- e. Manual of operations or product manual; and
- f. At least 2 full time account officers for microfinance operations.

V. Performance Standards for Microfinance (See Annex 3 for details)

After meeting the minimum institutional criteria, the microfinance operations of the MFI shall be subjected to the following performance standards:

1. **Portfolio Quality** – Two indicators below provide specific information on the state of financial health of the microfinance portfolio of the institution. Maintaining good portfolio quality is very important for continued delivery of microfinance services to the MFI's clients. Poor quality of loan portfolio will lead to losses to the institutions, making it difficult to sustain microfinance operations.

- a. **Portfolio at Risk (PAR) Ratio** – reflects the proportion of the microfinance loan portfolio with one day missed payment to the total microfinance loans outstanding at a given time, and shows the degree of riskiness of the total microfinance portfolio.

Since microfinance loans are usually small and are payable within a short period of time, the likelihood of default of the entire loan balance is high when one amortization payment is missed. The formula for this indicator is:

$\frac{\text{Principal Balance of Loans with At Least One Day Missed Payment}}{\text{Total Principal Loan Balance}}$
--

Restructured or refinanced loans shall be considered non-performing and no interest income shall be accrued thereon. These loans shall be included in computing PAR.

Restructured loans are loans that have been renegotiated or modified to either lengthen or postpone the original scheduled installment payments or substantially alter the original terms of the loan.

Refinanced loans are loans that have been disbursed to enable repayment of prior loans that would not have been paid in accordance with the original installment schedule. Refinanced loans shall be classified and treated as restructured loans.

STANDARD: 5%

- b. **Loan Loss Reserve Ratio** – indicates the degree of protection of the institution against expected losses due to delinquency.

An allowance should be provided once the microfinance loan is considered at risk, since the likelihood of default increases as amortization payments are missed. Hence, allowance for probable losses is based on PAR. Restructured and refinanced loans are considered as risky and should be provided the appropriate allowance.

As a general provision, all current microfinance loans shall be subject to a 1% loan loss provisioning. The following shall be the basis in computing for loan loss reserves:

	Required Reserves
Current	1%
PAR 1 to 30	2%
PAR 31 to 60 and/or loans restructured once	20%
PAR 61 to 90	50%
PAR 91 & above and/or loans restructured twice	100%

- **Loan Loss Reserve Ratio**

$\frac{\text{Total Reserves Provided}}{\text{Total Reserves Required}}$

STANDARD: 100% of the required reserve

2. **Efficiency** – The indicators under this category show whether the MFI is able to deliver microfinance services at the least cost to the institution. They also indicate the ability of the institution to generate sufficient income to cover the expenses related to the microfinance operations.

- a. **Administrative Efficiency** – measures the cost of managing the organization's assets.

$\frac{\text{Administrative Costs* (direct and indirect costs)}}{\text{Average Gross Loan Portfolio**}}$
--

*Administrative cost should include loan loss provision expense.

**(Beginning Gross Loan Portfolio + Ending Gross Loan Portfolio) ÷ 2

Indirect Costs is allocated in proportion to the number of personnel directly dedicated to each cost center. Indirect cost allocated to the microfinance operations is computed as:

$$\text{Indirect Costs} = (\text{Number of Full-time MF Staff} \div \text{Total Number of Full-time Staff}) \times \text{Total Indirect Costs}$$

Full-time MF Staff refers to employees working full-time in the microfinance operations regardless of employment status, i.e., whether contractual or regular.

Total Indirect Costs refers to costs shared by both the microfinance and non-microfinance operations. It includes, among others, salaries and benefits, rent, office materials and supplies, publications and publicity, transportation, travel and training for overhead staff, telephone and postage, insurance, utilities, repairs and maintenance, legal, audit and consultant fees, bank charges, taxes, and depreciation.

STANDARD: 10 % and below

- b. **Operational Self-Sufficiency** – indicates whether or not enough revenues are earned to fully cover the costs of the microfinance operations.

$\frac{\text{Interest Income from Loans} + \text{Service Fees} + \text{Filing Fees} + \text{Fines, Penalties, Surcharges}}{\text{Financing Costs} + \text{Administrative Costs (direct and indirect costs)}}^2$

STANDARD: greater than 120%

- c. **Loan Officer Productivity** – measures the ability of loan officers to service microfinance borrowers.

$\frac{\text{Number of Active Borrowers}}{\text{Number of Account Officers}}$

STANDARD: Group: greater than or equal to 300
Individual: greater than or equal to 150

3. **Sustainability** – Two indicators below measure the ability of the institution to continuously finance its microfinance operations from internally generated funds in the long run without any subsidy.

- a. **Financial Self-Sufficiency** – indicates whether the organization is earning enough revenue to sufficiently cover in the long-run all operating costs and at the same time maintain the value of its capital and assets, without the need for subsidy.

$\frac{\text{Operating Revenue}}{\text{Financial Expense} + \text{Loan Loss Provision Expense} + \text{Adjusted Expenses}^*}$

²Same as Administrative Cost used for computing Administrative Efficiency.

**Adjusted Expenses = Total Operating Expense + [(Average Equity – Average Fixed Assets) x Inflation Rate] + [(Market Interest Rate x Average Total Liabilities) – Actual Interest Expense] + Other Implicit Costs. Other Implicit Costs include those costs relevant to the conduct of its business such as grants, rent free building, donor paid technical advisor, or other subsidized expenses.*

STANDARD: greater than 100%

- b. **Loan Portfolio Profitability** – measures the proportion of net revenues generated from the MF lending operations to the MF loan portfolio. This ratio indicates whether earnings can sufficiently cover the annual depreciation of the peso.

$\frac{\text{Net Operating Income}}{\text{Average Net MF Loan Portfolio}}$
--

STANDARD: greater than the inflation rate during the period

4. **Outreach** - These indicators show the extent of reach of the MFI. They take into account the growth in the number of the active clients, the expansion of the microfinance portfolio, and the depth of outreach.

- a. **Growth in Number of Active MF Clients³** - measures the ability of the MFI to expand its operations through increases in its active clients (referring to those with outstanding MF loans with the institution).

$\frac{\text{Ending No. of Active MF Clients} - \text{Beginning No. of Active MF Clients}}{\text{Beginning No. of Active MF Clients}}$
--

STANDARD: ≥ 5%

- b. **Growth in Microfinance Loan Portfolio** – determines the rate of expansion of the MF loan portfolio, which may be a result of an increase in the number of active clients or in the loan amounts, or a combination of both.

$\frac{\text{Ending MF Loans Outstanding} - \text{Beginning MF Loans Outstanding}}{\text{Beginning MF Loans Outstanding}}$
--

STANDARD: ≥ 5%

- c. **Depth of Outreach** – indicates whether the MFI provides micro-financial services to clients belonging to the lower income segment of the economy.

$\frac{\text{Total Loans Outstanding}}{\text{Total Number of Active Borrowers}}$ <p style="text-align: center;"><i>GNP per Capita</i></p>

³ All reference to growth rates should be computed on an annual basis. To get growth rate for a specific month, variable should be compared with the performance of the same variable in the previous year. For instance, to get the growth rate of clients as of November 2000, the no. of clients in November, 2000 should be compared with the no. of clients in November, 1999.

STANDARD: Not exceeding 20%

VI. Rating System

1. Portfolio Quality (40%)

a. Portfolio At Risk

Score	Equivalent Points
5% or less	20
> 5% to 10%	15
> 10% to 15%	10
> 15% to 20%	5
Above 20%	0

b. Loan Loss Reserve Ratio

Score	Equivalent Points
100%	20
70% to < 100%	15
50% to < 70%	10
30% to < 50%	5
Below 30%	0

2. Efficiency (30%)

c. Administrative Efficiency

Score	Equivalent Points
0 to 10%	10
> 10% to 15%	6
> 15 to 20%	4
Above 20%	0

d. Operational Self-Sufficiency

Score	Equivalent Points
120% & above	10
115% to < 120%	8
110% to < 115%	6
105% to < 110%	4
100% to < 105%	2
Below 100%	0

e. Loan Officer Productivity

Score	Equivalent Points
For group loans:	
300 and above	5
250 to 299	3
200 to 249	1
Below 200	0

For individual loans:	
150 and above	5
100 to 149	3
50 to 99	1
Below 50	0

Note: If MFI is using only one methodology, MFI gets an additional 5 points

3. Sustainability (15%)

f. Financial Self-Sufficiency

Score	Equivalent Points
100% & above	10
95% to < 100%	8
90% to < 95%	6
85% to < 90%	4
80% to < 85%	2
Below 80%	0

g. Loan Portfolio Profitability

Score	Equivalent Points
Greater than inflation rate	5
Equal to inflation rate	3
Less than inflation rate	0

4. Outreach (15%)

h. Growth in Number of Active Microfinance Clients

Score	Equivalent Points
5% or higher	5
0 to 5 %	3
Below 0	0

i. Growth in Microfinance Loan Portfolio

Score	Equivalent Points
5% or higher	5
0 to 5 %	3
Below 0	0

j. Depth of Outreach

Score in Percent	Equivalent Points
≤ 20	5
> 20 - 100	4
>100 -150	3
>150-200	2
>200-300	1
>300	0

VII. Overall Adjectival Rating

- **Rating 1 (90 to 100) – Excellent.** The MFI has strong performance that provides safe and sound operation. The microfinance operations of institutions in this category are resistant to external shocks and financial disturbances and are able to withstand adverse changes in the business environment.
- **Rating 2 (80 to 89) – Very Satisfactory.** The MFI has satisfactory performance. They have safe and sound operations and are able to withstand business fluctuations. However, there are some areas in its operations that need special attention which, if left unchecked may negatively affect its microfinance operations.
- **Rating 3 (70 to 79) – Satisfactory.** There are areas in the microfinance operations that need special attention. Key performance measures indicate that the operations may be adversely affected and may deteriorate further when left unchecked.
- **Rating 4 (Below 70) – Needs Improvement.** The microfinance operation has serious problems and needs close supervision.

Annex 1

Regulatory Framework for Microfinance in the Philippines

The government recognizes microfinance as one of the important tools in the current government's fight to alleviate poverty. This is clearly articulated in the President's State of the Nation Address (SONA) in July 2001. The specific policies and strategies to be pursued for the effective delivery of microfinance services are spelled out in the National Strategy for Microfinance (NSM). The government's microfinance policy is built on the following principles:

- *Greater role of private microfinance institutions (MFIs) in the provision of financial services;*
- *An enabling policy environment that will facilitate the increased participation of the private sector in microfinance;*
- *Market-oriented financial and credit policies, e.g. market-oriented interest rates on loan and deposits;*
- *Non-participation of government line agencies in the implementation of credit and guarantee programs.*

Using these policy principles, a framework for the development of the microfinance industry was formulated. This framework provides the government's thrust and policy direction for the microfinance industry and delineates the role and the responsibilities of each of the players⁴ in the microfinance industry in both the public and the private sector.

The government's clear policy directions on microfinance resulted in an increased number of private institutions engaged in the provision of micro-finance services. Because of this, appropriate supervision and regulation of microfinance institutions is an important issue that has recently been brought to the fore by both the government and the microfinance practitioners. Appropriate regulation and supervision of microfinance is important to ensure that risks associated with microfinance are minimized and appropriately managed by the concerned MFIs. The continued viability and sustainability of these institutions is important for microfinance to effectively contribute to the poverty alleviation objective.

Recognizing the importance of appropriate regulation in ensuring the delivery of sustainable and efficient microfinance services, the Executive Committee of the National Credit Council (NCC) and the National Anti-Poverty Commission

⁴ *The Framework for Microfinance Development categorizes the following players in the microfinance industry: the clients, microfinance institutions, wholesale lenders, service institutions, and concerned government agencies involved in microfinance policy formulation and regulation. The framework outlines the different activities that will be pursued by the concerned players given the policies and strategies espoused in the National Strategy for Microfinance. This regulatory framework forms part of the Framework for the Development of Microfinance.*

(NAPC) created a technical working group,⁵ which is tasked to work on the formulation of an appropriate regulatory framework for microfinance. This paper provides such framework.

I. What is microfinance?

Microfinance is the viable and sustainable provision of a broad range of financial services (savings and credit) generally, by the private sector to poor and low-income households⁶ engaged in livelihood and microenterprise activities using non-traditional and innovative methodologies and approaches (e.g. non-collateralized cash-flow based lending). The maximum individual loan amount provided for microfinance loans is P150,000.⁷

II. Vision for microfinance

*To make microfinance the cornerstone for poverty alleviation, the vision is to have a **viable and sustainable private (micro) financial market**. This will be achieved in a liberalized and market-oriented economy where the private sector plays the major role and the government provides the enabling environment (through the appropriate policy and institutional framework) for the efficient functioning of markets. (National Strategy for Microfinance, 1997). This will be achieved through among other things, the following:*

- i. Adoption of market-based financial and credit policies*
- ii. Greater private sector participation in the delivery of microfinance services to the basic sector*
- iii. Establishment of an appropriate regulatory framework for microfinance*

⁵The Technical Working Group (TWG) is composed of representatives from the following government agencies: Bangko Sentral ng Pilipinas (BSP), Cooperative Development Authority (CDA), Philippine Deposit Insurance Corporation (PDIC), Peoples Credit and Finance Corporation (PCFC), National Anti-Poverty Commission (NAPC), Land Bank of the Philippines (LBP), Development Bank of the Philippines (DBP), Department of Labor and Employment (DOLE), National Commission on the Role of Filipino Women (NCRFW), Agricultural Credit Policy Council (ACPC). The TWG is also composed of representatives from the private sector i.e. Rural Bankers Association of the Philippines (RBAP), National Confederation of Cooperatives (NATCCO), and the Microfinance Council of the Philippines (MCP).

⁶The 1997 NEDA poverty estimates show that the established annual per capita poverty threshold for the Philippines is P11,319. The annual per capita poverty threshold in the urban areas and rural areas is P12,577 and P10,178 respectively. Below this threshold or minimum income, that individual will be considered "poor."

⁷ This definition is consistent with the provisions of RA 8425 (Social Reform Agenda).

III. Objectives of the Regulatory Framework

- A. To protect the financial system from unsound (i.e. excessively risky) practices by deposit-taking institutions (either from the public or its members) and thereby, protect the country's payments system;
- B. To protect small clients; and
- C. To promote the establishment of an accurate, reliable and transparent set of financial information for all types of MFIs.

IV. Scope of Microfinance Regulation

Only institutions taking deposits from the general public and/or from its members are subject to prudential regulation and supervision. Since microfinance NGOs are not supposed to take deposits from their clients, they will not be subjected to prudential regulations. However, those microfinance NGOs that collect savings beyond the compensating balance will be subject to the appropriate regulatory agency.

V. Definition of Terms

- A. **Compensating balance** – this refers to the proportion of the total loan of an MFI client, which is retained with the MFI as capital build-up or savings. This amount serves as a hold-out deposit on the loan of the client and can be used by the MFI to off-set the client's outstanding balance in case of default. In view of this, the client is considered a net borrower from the MFI rather than a net saver (i.e. as a borrower of his own savings rather than as a depositor who finance other client's borrowings/loans).
- B. **Deposit-taking Institutions** – these are financial institutions engaged in the mobilization of savings either from its own members or from the general public.
- C. **Micro Finance Institutions (MFIs)** –these are institutions engaged in the delivery of microfinancial services (e.g. microsavings and microcredit). Examples of these institutions are rural banks and cooperative banks, thrift banks, credit cooperatives and microfinance NGOs.
- D. **Microfinance Regulation** – this refers to the issuance of the necessary rules and regulation, including cancellation, suspension and sanctions, governing the intermediation of microfinancial services. The rules and regulations are expected to make sure that all microfinance institutions

employing innovative and non-traditional lending methodologies are using sound and prudent practices in their operations.

- E. **Retail Microfinance Institutions** - these are financial institutions that provide direct micro-financial services to microfinance clients.*
- F. **Regulation** – the act of defining and establishing a set of rules and regulations governing the intermediation of financial resources between savers and borrowers. This also includes the issuance of necessary measures to ensure that financial intermediaries operate in a sound and prudent manner. Rules and regulations are issued to ensure the stability of the payments system.*
- G. **Risk-based Supervision** - this is a supervision approach wherein the supervisor/examiner identifies, classifies and measures the different types of risks faced by the financial institutions in its operations.*
- H. **Supervision** – this refers to the systematic oversight of micro finance institutions to ensure their compliance with the established rules and regulations.*
- I. **Wholesale Microfinance Institutions** – these are financial institutions, which lend out loanable funds to microfinance institutions.*

VI. Current Situation of Regulatory Environment

- A. At present, there are a number of institutions involved in the delivery of micro-financial services to the basic sectors, e.g. the rural banks, thrift banks, credit cooperatives and the micro-finance NGOs. Thrift banks and rural banks are currently being supervised by the Bangko Sentral ng Pilipinas (BSP) while the credit cooperatives are legally under the supervision of the Cooperative Development Authority (CDA). The microfinance NGOs are not being supervised nor regulated by any government regulatory agency.*
- B. Regulatory Environment for Banks*
 - B.1. The BSP is the regulatory authority over all banking institutions including those engaged in the provision of micro financial services. BSP issues the necessary rules and regulations for the safe and prudent operations of banks. As part of its regulatory mandate over banks, BSP supervises and conducts regular examination of banks. During examination, examiners check for compliance with banking laws, rules and regulations, soundness of systems for evaluating credit, supervision and collection of loans and the quality of the loan portfolio. While the laws and regulations do not prohibit micro-enterprise lending, most banks are not keen on providing micro-*

finance loans for fear of being penalized by bank examiners. A study conducted by the Credit Policy Improvement Program (CPIP) reported that lenders subject to BSP supervision guidelines and practices are unclear about the BSP's view on small, clean and unsecured loans that are supported by informal financial information.

B.2. With the issuance of the National Strategy for Microfinance in 1997, the NCC advocated for the issuance of the necessary measures to implement the policy principles and strategies espoused in the NSM. This led to the inclusion of certain provisions in the General Banking Law that specifically pertains to microfinance.

B.3. Section 40 of the General Banking Act of 2000 specifically recognized the peculiar characteristics of microfinance and directs the Monetary Board to issue relevant measures specifically to address the apprehension cited by most banks regarding microfinance. Hence, the following circulars were issued by the BSP:

- BSP Circular 272 dated January 30, 2001, which recognizes the peculiar characteristics of microfinance and directs its exemption from rules and regulations issued by the Monetary Board with regards to unsecured loans;*
- BSP Circular No. 273, dated January 30, 2001, which lifts the moratorium on bank branching for those banks engaged in microfinance activities;*
- BSP Circular No. 282 dated 19 April 2001 opens a rediscounting window for microfinance.*

C. Regulatory Environment for Credit Cooperatives

C.1. The Cooperative Development Authority is mandated under Republic Act 6539 to provide oversight functions for all types of cooperatives. However, despite its legal mandate to regulate and supervise credit coops and other coops with credit services, CDA is not effectively performing this function. CDA has been mostly engaged in development activities⁸, which is also allowed by their present charter. At present, the CDA does not supervise nor examine the books of credit cooperatives.

C.2. In 1997, the National Credit Council through the Credit Policy Improvement Program (CPIP) conducted a review of the regulatory environment for Credit Cooperatives. The review found out that the CDA is not able to effectively implement its regulatory mandate due

⁸ *The Cooperative Code adopts the principle of subsidiarity wherein the cooperative sector will take the lead in the conduct of development activities such as training, promotion and education.*

to conflicting mandates of regulation and development. In view of this, it has mostly been involved in the registration of cooperatives and in the conduct of promotion and development activities for cooperatives. Results of the review also showed that the CDA does not have the necessary basic information for the effective regulation of credit cooperatives (i.e. there is no standard chart of accounts and performance standards for credit cooperatives).

C.3. In 1998, the NCC, in coordination with the CDA, the credit cooperative sector and other government agencies working with the cooperative sector spearheaded work on the establishment of a standard chart of accounts for credit cooperatives and other types of cooperatives with credit services. The CDA has recently issued a circular directing all concerned primary credit cooperatives to adopt and implement the standard chart of accounts.

C.4. The NCC, in coordination with the CDA, the credit cooperative sector and other government agencies, is also currently working on the establishment and adoption of a set of performance standards for credit and other types of cooperatives with credit services.

D. Regulatory environment for Microfinance NGOs

D.1. At present, there is no single agency that has supervision over microfinance NGOs. Microfinance NGOs register with the Securities and Exchange Commission (SEC) as a non-stock, non-profit organization. SEC, however only registers microfinance NGOs. It does not regulate nor supervise them. In view of this, microfinance NGOs do not report to any oversight agency (whether private or public) and hence, there is no single institution that has a complete set of relevant information on the financial performance of microfinance NGOs.

D.2. Almost all microfinance NGOs collect forced savings (sometimes referred to as capital build-up) from their borrower-clients. A number of them argue that the savings they collect from their members are only compensating balances. In view thereof, there is consensus among microfinance NGOs that they should be allowed to collect savings from their clients without prudential regulation provided that these do not exceed their total loan portfolio. There is concern, however that a number of microfinance NGOs may have collected savings beyond the compensating balance.

D.3. As mentioned earlier, there is no available set of uniform and transparent information that can be used to determine whether the savings collected by the microfinance NGOs are only compensating balances. Since no single agency collects a uniform and transparent set of information among microfinance NGOs. While the

Microfinance Council of the Philippines (MCP) is an umbrella organization comprised mostly of microfinance NGOs, not all members submit relevant and uniform set of information to the Council.

D.4.To ensure that microfinance NGOs are operating in a viable and sustainable manner, the Microfinance Council of the Philippines has adopted a set of performance standards for microfinance NGOs. A standard chart of accounts has, likewise, been formulated. Both the performance standards and the standard chart of accounts are however, yet to be widely adopted by the microfinance NGOs.

D.5.The non-adoption of the performance standards and the standard chart of accounts by most microfinance NGOs is attributed to the absence of incentives for adoption.

D.6.The recommended chart of accounts for microfinance NGOs will be reviewed to make this comparable with the chart of accounts of the banks and the credit cooperatives. A technical working group comprised of representatives from both the microfinance practitioners and other stakeholders is currently reviewing the existing set of performance standards for microfinance NGOs. The review is aimed at coming up with a set of standards that are consistent with the performance standards for other types of MFIs (e.g., banks, cooperatives). The NCC will use the results of the review in the formulation of performance standards that cuts across all types of MFIs.

E. Role of Wholesale Financial Institutions

E.1. Generally, loanable funds for microfinance are provided by wholesale lenders that include the following: commercial banks, GFIs and the PCFC, a government-owned and controlled corporation which is specifically tasked to provide wholesale funds for microfinance.

E.2. Current government policy directs the GFIs to provide wholesale funds at market rates to private financial institutions engaged in microfinance.

E.3. Commercial banks also provide wholesale funds to private financial institutions engaged in microfinance using their own funds and adopting their own lending criteria.

VII. *Establishing the Regulatory Framework*

A. *Basic Premises*

A.1. *Should existing regulatory institutions lack the capability to effectively undertake the necessary regulatory functions for microfinance, appropriate measures will be adopted for the establishment of an alternative structure. Otherwise, necessary technical assistance for institutional strengthening will be sought from relevant donor agencies.*

A.1.1 *Only deposit taking institutions will be subjected to regulation.*

A.1.2 *Banks, including GFIs that provide wholesale funds for microfinance, will continue to be regulated by the BSP. General rules and regulations on bank supervision and examination will be applied. Specific rules⁹ to consider the peculiar and unique characteristics of microfinance services will only be applied where applicable, provided these will not unduly affect the stability of the financial system.*

A.1.3. *Credit cooperatives are under the regulatory authority of the CDA.*

A.1.4. *Microfinance NGOs are considered non-deposit taking institutions and therefore, will not be subject to prudential regulation and supervision by any government regulatory authority provided that the total savings collected from their clients should not exceed the total loan portfolio of the microfinance NGO at any point in time.*

◆ *Microfinance NGOs that collect savings beyond the compensating balance will be required to transform into a formal financial institution (either a credit coop or a bank) to be able to continue collecting savings from their borrower-clients.*

A.2. *Establishment of a transparent set of information to include sex disaggregated data for microfinance will be promoted among all types of microfinance institutions.*

⁹ *International best practice shows that risk-based supervision is most applicable for microfinance. In view of this, the supervision and examination process currently used by the BSP is currently being reviewed in the light of its impact on microfinance operations of the banks.*

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- ◆ *Since majority of microfinance clients are women, their specific needs should appropriately be considered in the design of microfinance products.*

A.3. *A credit information system containing data on all microfinance loans should also be established by the private sector.*

A.4. *There will be a core set of performance standards for microfinance operations for all types of financial institutions. These standards should be defined and be consistent with international best practices. These standards should likewise be endorsed and adopted by a rating agency, concerned MFIs and regulatory authorities.*

B. *Institutional Set-up for Micro-Finance Regulation (see Figure 1 for the Organigram)*

B.1. *Bangko Sentral ng Pilipinas*

B.1.1. *To act as the regulatory and supervisory authority for banks engaged in microfinance operations*

B.1.2. *To provide the necessary technical assistance to the regulatory unit for credit cooperatives within the CDA responsible for issuing appropriate rules and regulations for credit cooperatives and other cooperatives with credit services. These regulations should be consistent with existing regulations for banks with appropriate adjustments to consider the different structure of the credit cooperatives compared with banks.*

B.1.3. *To establish a credit information bureau for all loans, including microfinance loans, by all types of banks supervised by BSP.*

B.2. *Cooperative Development Authority*

B.2.1. *To act as the regulatory agency for credit cooperatives;*

B.2.2 *To establish a regulatory and supervisory unit for credit cooperatives responsible for the regulation of credit cooperatives and other types of cooperatives with credit services. This unit will coordinate closely and will be provided technical assistance by the BSP for the issuance of effective rules and regulations.*

B.2.3 *In the interim that CDA is not yet institutionally ready to directly conduct regulatory activities for credit*

cooperatives, accredited federations/unions of credit cooperatives and other types of cooperatives with credit services whose membership is voluntary may be authorized to perform quasi self-regulation. The federation/union will supervise and examine the operations of member-coops on a fee-basis using rules and regulations issued by the CDA. The recently approved set of performance standards will be used to rate and brand credit cooperatives and other types of cooperatives with credit services.

B.3 Microfinance Council of the Philippines

- B.3.1. The MCP is proposed to serve as the repository of information of microfinance NGOs¹⁰. Using information submitted by the different MFIs, the MCP will inform concerned regulatory authorities when a microfinance NGO collects savings from members beyond the compensatory balance.*
- B.3.2. The MCP may collaborate with the SEC and the Philippine Council for NGO Certification on the establishment of incentive mechanisms to enjoin all microfinance institutions (especially the microfinance NGOs) to submit a uniform and consistent set of information regarding their operational and financial performance.*
- B.3.3. In coordination with concerned agencies and the private sector, the MCP will work toward the establishment of a private risk-rating agency for all financial institutions involved in the delivery of microfinance services. Concerned regulatory authorities for each type of microfinance institutions may use the risk ratings of these institutions in their off-site supervision activities. Donors may also use the ratings in determining the necessary technical assistance appropriate for certain microfinance institutions.*

C. Establishment of the necessary infrastructure for financial transparency

C.1. Risk Rating Agency

- C.1.1 A private sector risk rating agency will be promoted to provide risk ratings for MFIs that will be used by concerned institutions such as the regulatory authority,*

¹⁰ *The microfinance NGO should issue a certification that it is not collecting savings from its clients beyond the compensatory balance. The MCP may use this certification as basis in monitoring the MFI's compliance with the law not to collect savings from the public.*

donors and wholesale financial institutions (e.g. GFIs and commercial banks) in evaluating the financial performance of the MFIs.

Risk ratings are expected to provide a clear and concise summary of the institutions' risk profile that can be understood by investors who have limited knowledge about the MFI's business operations.

- C.1.2 *Government should only provide an appropriate policy and institutional environment for private sector to initiate work on the establishment of a risk-rating agency.*

C.2. Credit Bureau for microfinance

- C.2.1 *A Credit Bureau for microfinance shall act as the repository of all credit information regarding microfinance clients;*

- C.2.2 *The credit bureau for bank clients may be established within the BSP. Technical assistance to initiate the establishment of the bureau may be sought from relevant donors.*

- C.2.3 *A privately initiated credit bureau may also be established to supplement the information from BSP. Information from a privately initiated credit bureau in most cases is more comprehensive than those from the credit bureau within the superintendency of banks. These include credit information of borrowers outside of the banking system (e.g. utilities bill, credit card, other MFI clients etc.).*

D. Minimum set of Parameters for assessing the performance of microfinance institutions

D.1. Portfolio Quality

- D.1.1. *Portfolio at risk*
D.1.2. *Past due ratio*
D.1.3. *Provision for loan losses*

D.2. Efficiency Indicators

- D.2.1. *Administrative efficiency*
D.2.2. *Operational self-sufficiency*
D.2.3. *Financial self-sufficiency*

D.3. Stability Indicators

D.3.1. Liquidity

D.3.2. Net institutional capital

D.4. Outreach Indicators for microfinance

D.4.1. Growth of no. of clients

D.4.2. Growth of microfinance loan portfolio

D.4.3. Growth of savings

E. Measures to be undertaken by concerned institutions

E.1. Bangko Sentral ng Pilipinas

E.1.1. Review existing regulatory, supervision and examination procedures and guidelines to consider the peculiar characteristics of microfinance. Adopt an appropriate approach for the supervision and examination of banks engaged in microfinance operations (e.g. risk based supervision approach).

E.1.2. Revise, when necessary, relevant rules, regulations and circulars to ensure that regulatory and supervisory guidelines and procedures do not pose as barriers for banks to engage in microfinance operations (e.g. branching guidelines, new banks guidelines, performance indicators, manual of examination etc.)

E.1.3. Provide appropriate technical assistance to the regulatory and supervisory unit of the CDA for credit cooperatives.

E.2. Cooperative Development Authority

E.2.1 Establish a regulatory unit for credit cooperatives

E.2.2 In coordination with the BSP, formulate and establish relevant regulatory guidelines, policies and procedures for the operations of credit cooperatives.

E.2.3 Issue rules and regulations for the effective supervision of credit cooperatives and other types of cooperatives with credit services.

E.2.4 Formulate and establish relevant supervision and examination procedures.

E.3 *Microfinance Council of the Philippines*

E.3.1. In coordination with the relevant stakeholders, formulate and establish necessary guidelines and systems for its effective functioning as the repository of information of all MFIs.

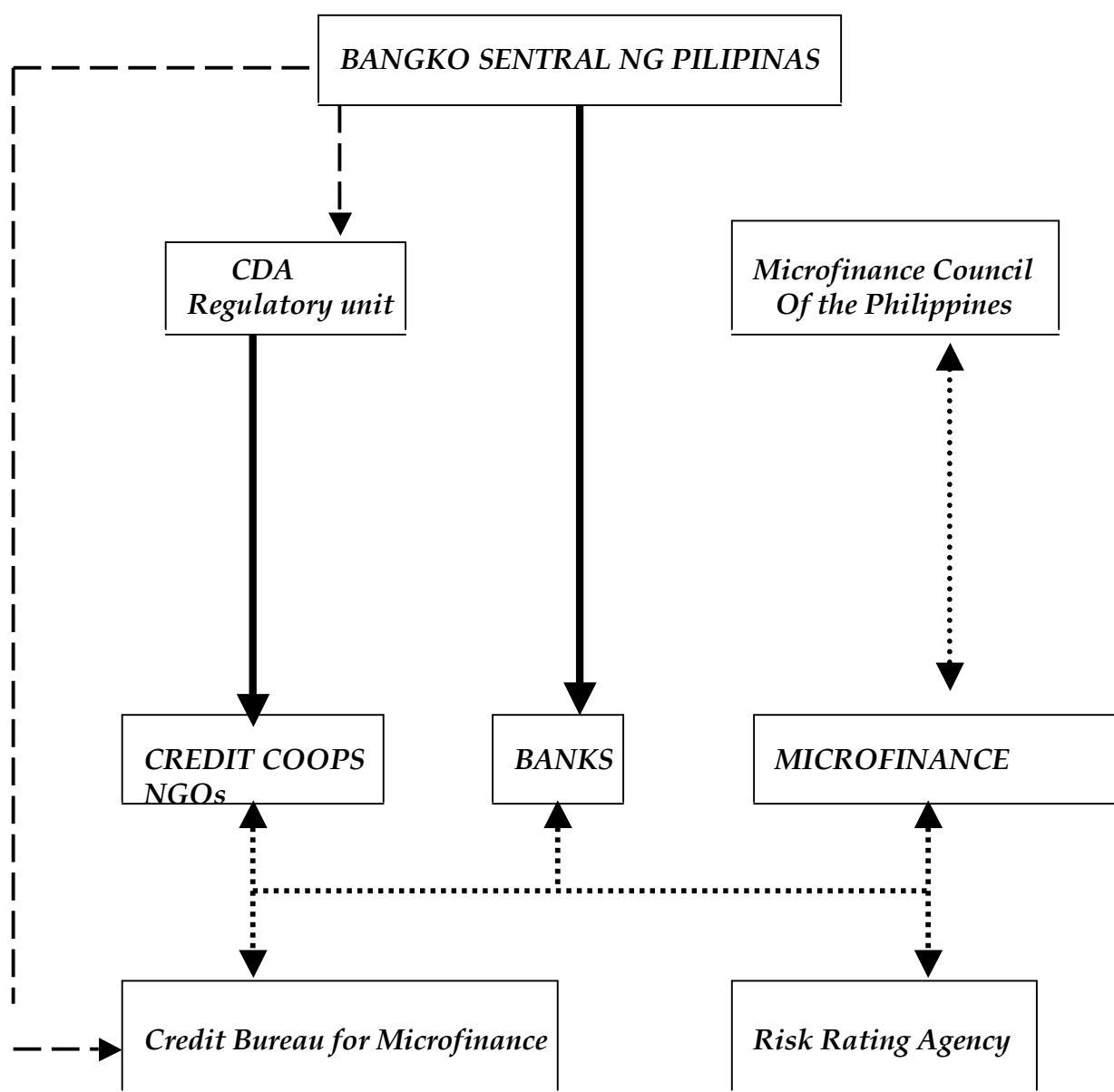
E.3.2. In coordination with the relevant stakeholders and with appropriate support from relevant government agencies, advocate and work towards the establishment of a credit bureau and risk rating agency for microfinance.

E.4. *National Credit Council*

E.4.1. In consultation with MFIs, relevant private organizations/networks and other concerned government agencies, formulate and establish performance standards for MFIs using the parameters identified in this framework as basis.

E.4.2. In consultation with concerned institutions (both public and private), promote and advocate for the establishment of a rating agency and a credit information system.

Figure 1
Proposed Institutional Set-up for the Regulation of Microfinance



Legend:

Direct supervision —————

Oversight - - - - -

Submission and assessment of relevant information

Attachment 1

National Strategy for Microfinance

THE PROBLEM

One of the major socio-economic problems besetting the Philippine economy is the pervasiveness of poverty. Based on the 1994 Family Income and Expenditure Survey (FIES), there are about 4.7 million poor Filipino households. This translates into a poverty incidence of 35.7 percent, with rural poverty incidence (53.7 percent) significantly higher than urban poverty incidence (28.8 percent).

A good number of poor households below the poverty line are engaged in microenterprises. A perennial problem of these microentrepreneurs is the lack of access to financial services. The latest NEDA survey indicated that less than 12 percent of low-income rural families borrowed since 1991. Of these, nearly two-fifths sourced their loans from relatives and friends while another one-third borrowed from private moneylenders and cooperatives. Only a small percentage relied on banks (government or private) for loans.

Because of information problems, inadequate collateral and the high transaction costs associated with processing small loans, private banks rarely, if at all, lend to microentrepreneurs. The borrowers themselves do not approach the banks due to burdensome requirements, high interest rates, lack of collateral and lack of information on possible sources of financing. As a result, the microenterprise credit market consists mostly of credit cooperatives, credit unions, some rural banks, and a handful of credit NGOs. Government agencies implementing various loan programs are also present.

In general, these microfinance institutions (MFIs) have limited outreach. Among MFIs, Cooperative banks and credit cooperatives have the widest estimated outreach. Recent field observations show that these two groups, together with rural banks and credit unions, have the network necessary to provide microfinance on a national scale.

ATTEMPTS TO ADDRESS THE PROBLEM

One of the government's strategies to alleviate poverty is to provide poor households engaged in microenterprise activities access to production and consumption-smoothing credit. Hence, in the 1970s and 1980s, the government created a number of directed credit and guarantee programs, especially in the agriculture sector. Some common features of these programs are:

- a) Funding came from government budgetary appropriations, the Central Bank's rediscounting window and foreign borrowings;*

b) Funds were provided through specialized banks (e.g., rural banks, development banks, and government financial institutions) for direct availment by the targeted borrowers; and

c) Funds were given at highly concessional rates.

These programs provided massive credit subsidies to bring down the cost of borrowing for the targeted sectors. But instead of benefiting small borrowers, the eventual credit rationing and high loan defaults enabled large-scale borrowers to capture the subsidies. Moreover, due to the availability of cheap loan funds, deposit mobilization was neglected leading ultimately to the weakening of rural banks.

These experiences, coupled with the fiscal costs of the programs, led the government to pursue financial market reforms in the mid-1980s. These reforms included:

a) Adoption of market-oriented interest rates;

b) Termination of subsidized rediscounting programs at the Central Bank;

c) Consolidation of existing agricultural credit programs into the Comprehensive Agricultural Loan Fund (CALF) which served as a loan guarantee fund for agricultural loans granted by banks; and

d) Termination of direct lending by government agencies implementing agricultural credit programs.

While these reforms were introduced and implemented in the agricultural sector, there was a proliferation of programs in other sectors. Subsidized credit programs for small and medium-scale enterprises as well as for livelihood projects multiplied. Many of these were implemented through government agencies. At the same time, laws were passed mandating loan quotas for targeted sectors. These include the Argi-Agra Law (PD717), the Magna Carta for Small and Medium Enterprises (RA6977) and the Magna Carta for Small Farmers.

With the Ramos Administration came, increased emphasis on private sector participation. The 1991-1998 Medium-term Philippine Development Plan articulated the government's twin strategies of global competitiveness and people empowerment. In the financial sector, these meant the implementation of market-based financial and credit policies and the increased participation of the private sector in the marketplace. The government will only play an enabling and strategic role through the provision of an appropriate policy environment for markets to function efficiently. Government financial institutions, on the other hand, will be re-oriented toward supplementing the private sector's initiative in providing financial services to microentrepreneurs.

Even as the government pursued reforms to enhance market efficiency, it adopted the Social Reform Agenda (SRA) to address the poverty problem in the country. Among others, the SRA's action agenda include providing the poor access to economic opportunities within a liberalized and deregulated market. This has encouraged a

number of financial (rural banks, cooperatives, etc.) and non-financial (credit NGOs) institutions to engage in innovative lending techniques to address the credit demand of microentrepreneurs. However, despite the avowed market orientation of financial and credit policies, there is still pressure from various interest groups for government to provide credit subsidies and create a more directed credit programs.

The result is a basic inconsistency between microfinance policies and credit programs intended to support those policies. The policy-program inconsistency creates a flawed incentive structure that encourages various players in the microfinance market to pressure government for more credit subsidies, loan quotas and other distortionary measures. The end product is a microfinance market that appears more constrained in providing the target clientele access to financial services.

THE VISION AND THE OBJECTIVE

*The vision is to have a **viable and sustainable private (micro) financial market**. This will be achieved in a liberalized and market-oriented economy where the private sector plays the major role and the government provides enabling environment (through the appropriate policy and institutional (framework) for the efficient functioning of markets.*

Specifically, the objective is to provide low income households and microenterprises access to financial services. The target group consists of those who live below the poverty line and are engaged in some form of business or economic activity, but who do not have access to or are inadequately served by the formal financial sector.

REALIZING THE OBJECTIVE

The Policy Framework

In accordance with the vision, private microfinance institutions (MFIs) will provide microentrepreneurs financing services on available and sustainable basis while the government will provide a competitive and liberalized market environment. The government's microfinance policy is built on the following principles:

- *Greater role of the private sector (MFIs) in the provision of financial services;*
- *An enabling policy environment that will facilitate the increased participation of the private sector in microfinance;*
- *Market-oriented financial and credit policies, e.g. market-oriented interest rates on loan and deposits;*
- *Non-participation of government line agencies in the implementation of credit and guarantee programs.*

Hence, the government will avoid costly, unsustainable and distorting credit subsidies that, in the past, failed to reach their intended beneficiaries, led to the weakening of the rural banking system, and saddled the government with huge fiscal burden. Instead, emphasis will be placed on financial intermediation to ensure the efficient channeling of surplus financial resources to viable projects. A conscious effort will, therefore, be made to promote savings mobilization by MFIs.

Moreover, credit policy will be distinguished from welfare policy. Welfare assistance will be provided to address the needs of the really poor households through the appropriate government departments. Welfare will not be extended through financial institutions, whether government or private.

Credit demand of microentrepreneurs, on the other hand, will be met through a variety of innovative financial products provided by the private microfinance market. The government will assist in capacity building of MFIs and in providing the appropriate supervisory and regulatory framework to make markets more efficient and institutions, more viable.

The Institutional Framework

Given the policy framework, the respective roles of the various players in microfinance, based on their relative comparative advantages, are:

- **Microfinance Institutions (MFIs):** to engage in sound, sustainable and viable microfinance intermediation;
- **National Government through the National Credit Council (NCC):** to provide a market-oriented financial and credit policy environment which will promote efficient financial markets and will help MFIs broaden and deepen their microfinance services;
- **People's Credit and Finance Corporation (PCFC):** to provide wholesale funds and technical assistance to MFIs; to support the development of innovative financial products and services for microentrepreneurs;
- **Commercial and other private banks:** to provide wholesale funds and financial services to MFIs;
- **Government Financial Institutions (GFIs):** to provide wholesale funds (including those sourced from foreign borrowings) to MFIs that do not have access to funds from private commercial banks;
- **NGOs:** to facilitate linkages between microentrepreneurs on one end and MFIs and community organizations on the other end; to assist in capacity building of target clientele;

-
- **Donors:** to provide assistance for social preparation activities that will broaden and deepen microfinance services (e.g., development of microfinance products, training in microfinance technologies, and upgrading of performance standards, operating systems and procedures); to assist in areas that have been identified through a consultative process between the NCC and MFIs.

The Strategies to Be Pursued

The following strategies, aimed at providing microentrepreneurs greater access to microfinance services, will be pursued:

- a) Provision of a financial and credit policy environment that is conducive to the effective and efficient functioning of the financial market. This will be done by:
 - Implementing a market-oriented interest rate policy
 - Pursuing financial policy reforms with the end view of removing existing distortions in the financial market (e.g., loan quotas, earmarking of public funds for direct lending, etc.)
 - Rationalizing all existing government credit and guarantee programs towards encouraging greater private sector participation in a market-oriented setting
- b) Establishment of a market-oriented financial and credit policy environment which is conducive to the broadening (development of new product lines and services, implementation of new microfinance technologies and practices) and deepening (increased microfinance intermediation) of microfinance services. This will be accomplished by:
 - Providing the appropriate supervisory and regulatory framework for MFIs that will enable them to develop new and innovative product lines and services to cater to the demands of poor households and microenterprises;
 - Establishing standards of performance and business practices to guide the operations of MFIs;
 - Promoting broad-based savings mobilization, linking banking technology with microfinance technologies;
 - Providing information and training to MFIs on best practices in microfinance.

c) Implementation of a capacity-building program for MFIs. This will be implemented by:

- Providing technical assistance to MFIs, stressing (1) local deposit mobilization, (2) financial and project management, (3) use of information technology, (4) development and establishment of microfinance technology, innovative product/service lines.
- Documenting, packaging and disseminating practitioner-based training and technical services to MFIs, through the PCFC.
- Encouraging research and academic institutions to conduct studies and convene policy level discussions that will promote awareness of microfinance as a sound commercial investment. These institutions will identify best practices in microfinance, develop and install training and microfinance technology packages.

Annex 2

Members of the Technical Working Group (TWG)

The Technical Working Group is comprised of representatives from the following:

- *Bangko Sentral ng Pilipinas (BSP)*
- *Cooperative Development Authority (CDA)*
- *Credit Policy Improvement Program (CPIP)*
- *Credit Union Empowerment and Strengthening (CUES) Program in Mindanao*
- *Department of Finance (DOF)-National Credit Council (NCC)*
- *Department of Labor and Employment (DOLE)*
- *Development Bank of the Philippines (DBP)*
- *Land Bank of the Philippines (LBP)*
- *Microenterprise Access to Banking Services (MABS)*
- *Microfinance Council of the Philippines (MCPI)*
- *National Anti-Poverty Commission (NAPC)*
- *National Confederation of Cooperatives (NATCCO)*
- *National Economic and Development Authority (NEDA)*
- *People's Credit and Finance Corporation (PCFC)*
- *Philippine Deposit Insurance Corporation (PDIC)*
- *Rural Bankers Association of the Philippines (RBAP)*
- *Securities and Exchange Commission (SEC)*

Annex 3

Summary of the Performance Standards for Microfinance (P.E.S.O.)

Area	Indicator	Definition/Ratio	Standard	Weight
I. PORTFOLIO QUALITY				40
	Portfolio at Risk	$\frac{\text{Balance of loans with at least one day missed payment}}{\text{Total Loans Outstanding}}$	PAR - 1 5 %	20
	Loan Loss Reserve Ratio	$\frac{\text{Total Allowance Provided}}{\text{Total Required Allowance}}$	Required Reserves: Current – 1% PAR 1 to 30 – 2% PAR 31 to 60 – 20% PAR 61 to 90 – 50% PAR 91 & above and/or loans restructured twice – 100%	20
II. EFFICIENCY				30
	Administrative Efficiency	$\frac{\text{Administrative Costs}^{1/} \text{ (Direct \& Indirect Costs}^{2/})}{\text{Average Gross Loan Portfolio}^{3/}}$	10% & below	10
	Operational Self-sufficiency	$\frac{\text{Interest Income from Loans + Service Fees + Filing Fees + Fines, Penalties, Surcharges}}{\text{Financing Costs + Administrative Costs (Direct \& Indirect costs)}}$	≥ 120%	10
	Loan Officer Productivity	$\frac{\text{Number of Active Borrowers}}{\text{Number of Account Officers}}$	<ul style="list-style-type: none"> Group – ≥ to 300 Individual - ≥ to 150 	10
III. SUSTAINABILITY				15
	Financial Self-sufficiency	$\frac{\text{Operating Revenue}}{\text{Financial Expense + Loan Loss Provision Expense + Adjusted Expenses}^{4/}}$	≥ 100%	10
	Loan Portfolio Profitability	$\frac{\text{Net Operating Income}}{\text{Average Net MF Loan Portfolio}}$	Greater than inflation rate during the period	5

Area	Indicator	Definition/Ratio	Standard	Weight
IV. OUTREACH				15
	Growth in Number of Active MF clients	$\frac{\text{Ending No. of Active MF Clients}^{5/} - \text{Beginning No. of Active MF Clients}}{\text{Beginning No. of Active MF Clients}}$	Increasing	5
	Growth in Microfinance Loan Portfolio	$\frac{\text{Ending MF Loans Outstanding} - \text{Beginning MF Loans Outstanding}}{\text{Beginning MF Loans Outstanding}}$	Increasing	5
	Depth of Outreach	$\frac{\text{Total Loans Outstanding} \div \text{Total Number of Borrowers}}{\text{GNP per Capita}}$	20% or below	5
TOTAL				100

^{1/} Administrative cost should include loan loss provision expense.

^{2/} $(\text{Beginning Gross Loan Portfolio} + \text{Ending Gross Loan Portfolio}) \div 2$

^{3/} **Indirect Costs** is allocated in proportion to the number of personnel directly dedicated to each cost center. Indirect cost allocated to the microfinance operations is computed as:

$$\text{Indirect Costs} = (\text{Number of Full-time MF Staff} \div \text{Total Number of Personnel}) \times \text{Total Indirect Costs}$$

Where:

- **Full-time MF Staff** – refers to employees working full-time in the microfinance operations regardless of employment status, i.e., whether contractual or regular.
- **Total Indirect Costs** – refers to costs shared by both the microfinance and non-microfinance operations. It includes, among others, salaries and benefits, rent, office materials and supplies, publications and publicity, transportation, travel and training for overhead staff, telephone and postage, insurance, utilities, repairs and maintenance, legal, audit and consultant fees, bank charges, taxes, and depreciation.

^{4/} **Adjusted Expenses** = Total Operating Expense + [(Average Equity – Average Fixed Assets) x Inflation Rate] + [(Market Interest Rate x Average Total Liabilities) – Actual Interest Expense] + Other Implicit Costs. Other Implicit Costs include those costs relevant to the conduct of its business such as grants, rent free building, donor paid technical advisor, or other subsidized expenses.

^{5/} Active MF clients shall be those clients with savings and/or loans.

MEMORANDUM OF AGREEMENT

KNOW ALL MEN BY THESE PRESENTS:

This Agreement made and entered into by and among the following agencies:

Department of Finance, hereinafter referred to as **DOF**, with principal office at the BSP Complex, Roxas Boulevard, Manila, duly represented by its Secretary;

Bangko Sentral ng Pilipinas, hereinafter referred to as the **BSP**, with principal office at the BSP Complex, Roxas Boulevard, Manila, duly represented by its Governor;

Cooperative Development Authority, hereinafter referred to as **CDA**, with principal office at Ben-Lor Building, 1184 Quezon Avenue, Quezon City, duly represented by its Chairman;

Securities and Exchange Commission, hereinafter called **SEC**, with principal office at the SEC Building, EDSA, Mandaluyong City, duly represented by its Chairman;

People's Credit and Finance Corporation, hereinafter referred to as **PCFC**, with principal office at the Accelerado Building, 395 Senator Gil Puyat Avenue, Makati City, duly represented by its President;

Land Bank of the Philippines, hereinafter called **LBP**, with principal office at the LBP Building, 1598 M.H. del Pilar corner Quintos Street, Manila, duly represented by its President;

Development Bank of the Philippines, hereinafter called **DBP**, with principal office at the DBP Building, Gil Puyat Avenue, Makati City, duly represented by its President;

Microfinance Council of the Philippines, hereinafter called **MCP**, with principal office at 1909 Jollibee Plaza Condominium, Emerald Avenue, Pasig City, duly represented by its Executive Director;

Rural Bankers Association of the Philippines, hereinafter called **RBAP**, with principal office at the RBAP Building, Arzobispo Street, Intramuros, Manila, duly represented by its President;

National Confederation of Cooperatives, hereinafter called **NATCCO**, with principal office at 227 J.P. Rizal Street, Project 4, Quezon City, duly represented by its Chief Executive Officer;

WITNESSETH

WHEREAS, the National Credit Council (NCC), an inter-agency body chaired by the DOF, formulated and approved the Regulatory Framework for Microfinance Institutions (MFIs) in July 2002;

WHEREAS, the Framework specifically directed the NCC, in coordination with concerned stakeholders, to formulate and develop a uniform set of performance standards that will cut across all types of private financial institutions involved in microfinance operations;

WHEREAS, the NCC, through a Technical Working Group (TWG) composed of both public and private sector representatives, developed and formulated the Uniform Set of Performance Standards for MFIs (hereinafter referred to as the Standards);

WHEREAS, after a series of regional consultations and a 6-month pilot test, the TWG finalized the Microfinance Standards;

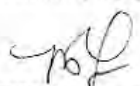
WHEREAS, the Standards, known as PESO (Portfolio Quality, Efficiency, Sustainability, Outreach), was formally launched on November 18, 2004 in Malacanang as part of the celebration for the United Nations International Year of Microcredit;

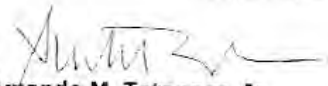
WHEREAS, the Standards will allow greater transparency in the operations of MFIs, as well as provide the necessary basic tools that will facilitate the evaluation and assessment of the operations of MFIs and compare their financial performances, regardless of whether it is a rural bank, credit cooperative or a microfinance NGO.

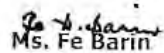
NOW, THEREFORE, for and in consideration of the foregoing premises, the parties involved herein, being members of the Technical Working Group that formulated the PESO Standards for MFIs, have agreed as they do hereby agree, to formally adopt and implement the Standards in whatever manner and purpose as they may deem necessary and


expedient, to ensure that MFI operations are efficient, sustainable and effective for the continued access to microfinancial services by the poor and the disadvantaged sectors of society.

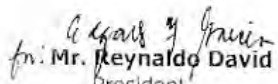
This Memorandum of Agreement shall take effect immediately on this 10th day of October, in the Year of Our Lord Two Thousand and Five. IN WITNESS WHEREOF, the parties to this Agreement have hereunto affixed their signatures.

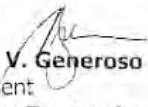

Hon. Margarito Teves
Secretary
Department of Finance

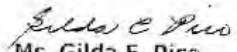

Hon. Amando M. Tetangco, Jr.
Governor
Bangko Sentral ng Pilipinas

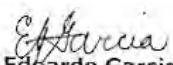

Ms. Fe Barin
Chairperson
Securities and Exchange Commission



Ms. Leslie V. Juarez
Chairperson
Cooperative Development Authority



for: Mr. Reynaldo David
President
Development Bank of the Philippines


Mr. Edgar V. Generoso
President
People's Credit and Finance Corporation


Ms. Gilda E. Pico
Acting President
Land Bank of the Philippines


Mr. Edgardo Garcia
Executive Director
Microfinance Council of the Philippines


Gen. William Hotchkiss III
President
Rural Bankers Association
of the Philippines


Mr. Cresente Paez
Chief Executive Officer
National Confederation of Cooperatives